STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company	)	
	)	
Application for Review of Alternative Regulation Plan	))	Docket No. 98-0252
Illinois Bell Telephone Company	)	
	)	
Petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates	)))	Docket No. 98-0335
Citizens Utility Board, People of the State of Illinois	))	Docket No. 00-0764
v.	)	
Illinois Bell Telephone Company	)	(Consol.)

REPLY BRIEF ON EXCEPTIONS OF AMERITECH ILLINOIS

Louise A. Sunderland
Karl B. Anderson
Mark A. Kerber
Illinois Bell Telephone Company
225 West Randolph Street, HQ-25D
Chicago, Illinois 60606
(312) 727-6705
(312) 727-7140
(312) 727-2928

Edward A. Butts
1800 West Hawthorne Lane, Room 102
West Chicago, Illinois 60185
(630) 562-1515

Dated: June 25, 2001

Table of Contents

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company Application for Review of Alternative Regulation Plan	))))	Docket No. 98-0252
Illinois Bell Telephone Company Petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates	)))))	Docket No. 98-0335
Citizens Utility Board, People of the State of Illinois v. Illinois Bell Telephone Company	))))	Docket No. 00-0764 (Consol.)

REPLY BRIEF ON EXCEPTIONS OF AMERITECH ILLINOIS

Illinois Bell Telephone Company (hereafter "Ameritech Illinois" or "the Company"), by its attorneys, hereby files its Reply Brief on Exceptions in the captioned proceeding. Briefs on Exceptions were filed by the Commission Staff ("Staff"), the Government and Consumer Intervenors and the City of Chicago, jointly ("GCI/City"), AT&T Communications of Illinois, Inc. ("AT&T"), the Department of Defense/Federal Executive Agencies ("DOD") and McLeodUSA Telecommunications Services, Inc. ("McLeodUSA").

I. SUMMARY OF POSITION

The arguments raised by the other parties in their Exceptions and Briefs on Exceptions primarily consist of restating positions rejected in the Proposed Order. Except where indicated herein, Ameritech Illinois supports the Proposed Order's resolution of these issues as reasonable, fully supported by the record evidence and consistent with sound public policy.

The most heavily contested issues continue to involve how to determine just and reasonable rates under a price regulation plan and whether Ameritech Illinois' rates should be reinitialized based on a conventional, rate case earnings analysis. The Proposed Order properly concluded that price regulation calls for a completely different regulatory approach to just and reasonable rates -- one that preserves the benefits created by price regulation and honors the risk/reward trade-offs which underlie the Alternative Regulation Plan ("Plan") which the Commission adopted in 1994. The Proposed Order properly rejected GCI/City's demands for rate reinitialization, recognizing the incompatibility between traditional rate cases and price regulation.

Fundamentally, GCI/City are caught in a regulatory policy time warp. Having participated for many years in revenue requirements proceedings before this Commission, they simply cannot conceive of a regulatory model which, at its core, does not rest on an analysis of earnings. CUB appealed the 1994 Order on the grounds that the Commission had impermissibly abandoned earnings as a standard for ratemaking and CUB lost. Illinois Bell Telephone Company v. Illinois Commerce Commission, 283 Ill. App. 3d 188 (2d Dist. 1996). Now again, in 2001, GCI/City raise essentially the same arguments -- that is, notwithstanding the fact that price regulation is fundamentally and critically different from rate of return regulation, the Commission must, as a matter of law, use earnings to determine whether rates are just and reasonable. They were wrong in 1994 and they are still wrong today.

As the Proposed Order concludes, earnings are not the measure of the Plan's success or failure. Price regulation plans address directly what rate of return regulation would address only indirectly: i.e., ensuring that the rates for Ameritech Illinois' noncompetitive services remain just and reasonable during the period when customers do not yet have adequate competitive alternatives. This function is performed by the price index which requires rate changes based on cost changes in the overall economy, less the offset for productivity gains which exceed those of the economy in general. Thus, as Staff and Ameritech Illinois agreed, success is primarily defined by whether prices for noncompetitive services were appropriate during the initial five-year term of the Plan, and they were.

Price regulation is superior to rate of return regulation precisely because it does not focus on earnings. Price regulation provides incentives to increase efficiency, invest in network modernization and (in Ameritech Illinois' case) assume responsibility for capital recovery precisely because the regulated company is allowed to earn well if it performs well and if economic conditions permit. It would send a chilling signal to Ameritech Illinois and all other telecommunications carriers in Illinois if the Commission were to change this regulatory compact just because the earnings outcome was different from what might have occurred under rate of return regulation.

Because GCI/City cannot move beyond the strictures of regulatory policies dating from the 1920's, they have provided no useful policy input to the Commission. For the telecommunications industry, rate of return regulation had fossilized well before 1994. Since then, competition and technology have continued to evolve at ever increasing rates of change. Contrary to GCI/City's views, rate of return regulation is simply not sustainable in this kind of market environment. Nowhere have GCI/City made any reasoned attempt to develop a theory of just and reasonable rates which reflects the policy objectives which led to the Commission's

1994 Order. Whatever label GCI/City attach to their rate reinitialization proposal, it constitutes reimposition of rate of return regulation on Ameritech Illinois and nothing more.

Beyond that, GCI/City's demand for massive price reductions of almost $1 billion bears no relationship to economic reality. If adopted by the Commission, this pricing proposal would have a devastating effect on competition, it would financially cripple Ameritech Illinois and it would disincent future investment in infrastructure in Illinois, not only by the Company, but by all carriers. Such a result would benefit no one in the long run -- not Ameritech Illinois' customers, whom GCI/City purport to represent; not competitors; and not the State of Illinois.

II. THE STATUTORY GOALS AND CRITERIA WERE MET[1]

A. FAIR, JUST AND REASONABLE RATES

GCI/City object to the Proposed Order's conclusion that the Plan produced fair, just and reasonable rates. GCI/City's core position is that this Commission must, as a matter of law, review Ameritech Illinois' earnings using a traditional earnings analysis and must reinitialize the Company's rates if those earnings exceed the level that would result under rate of return regulation. (GCI/City Br. on Exc., pp. 10-18). As the Proposed Order properly recognized, such a standard flies in the face of Section 13-506.1 itself, the policy underpinnings of price regulation and the Commission's 1994 Order implementing the Plan.

First, the meaning of the statutory terms "fair, just, and reasonable" under Section 13-506.1(a) and (b) must reflect the overall purpose of this Section. Section 13-506.1 of the Act clearly contemplates that the Commission may substitute alternative forms of regulation for rate of return regulation in toto:

---

[1] As explained in its Brief on Exceptions, Ameritech Illinois questions the value of separately reviewing the 10 issues which the Commission required the Company to address in its Petition for Review. (Am. Ill. Br. on Exc., p. 4, fn. 2). GCI/City has raised substantive objections to certain of the conclusions. (GCI/City Br. on Exc., pp. 6-10). The Company summarizes its responses to these issues in Appendix A, in the event the Commission maintains this section.

> "Section 13-506.1(a). Notwithstanding any of the ratemaking provisions of the Article or Article IX that are deemed to require rate of return regulation, the Commission may implement alternative forms of regulation in order to establish just and reasonable rates for noncompetitive telecommunications services including, but not limited to, price regulation, earnings sharing, rate moratoria, or a network modernization plan." (Emphasis added).

Thus, based on a plain reading of the statute, the meaning of "just and reasonable" rates must be based on something other than traditional rate of return principles. Otherwise, the statute is circular: that is, the Commission could approve alternative forms of regulation, but only if they produce precisely the same outcome as a traditional rate case. This is nonsensical and violates accepted canons of statutory construction. Collinsville Comm. Unit School Dist. No. v. Witte, 5 Ill. App. 3d 600, 602-03 (5th Dist. 1972).

It was well understood in 1994 that the Commission would not be applying earnings-based ratemaking standards to the Company on a going-forward basis. In fact, CUB appealed from the 1994 Order adopting the Plan, contending that it would permit Ameritech Illinois to earn "monopoly profits" and, therefore, was beyond the State's police power. CUB's arguments were categorically rejected by the Appellate Court:

> "The police power provides the authority to legislate for the public good; it does not specifically define the public good or the manner in which the legislature should act pursuant to its police power. The police power, therefore, does not mandate legislation to prevent excess profits. Even if the [Public Utilities] Act's original purpose were to prevent excess profits, this would not require all subsequent regulation of public utilities to share this purpose...." Illinois Bell Telephone Company, supra, at 202.

Having lost this legal argument over five years ago, GCI/City's effort to resurrect it should be rejected out of hand.

The other cases to which GCI/City cite have no bearing on the issues in this proceeding. Citizens Utility Board v. Illinois Commerce Commission involved a Commission Order approving a Centel rate plan which substituted usage sensitive service for flat rate calling.

Citizens Utility Board v. Illinois Commerce Commission, 276 Ill. App. 3d 730 (1995). It stands for the proposition that the Commission must consider the impact of rate design or rate restructuring on customers under its "just and reasonable" rate authority, relying in part on prior revenue requirements cases which describe the balancing test to which GCI/City cite. Id. at 736-37. The issue whether this Plan produced fair, just and reasonable rates has nothing to do with rate design or rate restructuring. There have been no changes in rate design since 1994 and certainly the Plan itself generated none.

The revenue requirements cases to which GCI/City cite are equally unavailing. They articulate standards which apply under rate of return regulation and only with respect to establishing the authorized return. They provide no guidance whatsoever under a price regulation plan, which is not based on earnings at all. This fundamental and critical distinction was clearly established in the decision on appeal of the Commission's 1994 Order, supra.

Furthermore, to the extent there needs to be a balancing of interests between Ameritech Illinois and consumers, that balancing took place in 1994 when the Plan was first adopted. In return for the opportunity to earn more than may occur under rate of return regulation, the Company undertook significant risks and responsibilities. First, Ameritech Illinois assumed responsibility for managing its capital recovery shortfall, without increasing customer rates. In fact, the Company has made significant progress in correcting past underdepreciation of its accounts, without impacting consumers. (Am. Ill. Ex. 1.1, pp. 19-20, 102-103; Am. Ill. Ex. 1.3, pp. 101-02). The Company assumed the risks associated with technological change, competition and the business cycle. The Company made a $3 billion commitment to invest in its network, regardless of financial conditions. The Company was obligated to make annual price changes based on an X factor which exceeded its historical productivity gains due to the inclusion of a

1.0% consumer dividend. Other components of the Plan were also established as customer protections. The Appellate Court concluded that the statutory standards established for alternative regulation plans generally, and the Commission's implementation of those standards relative to this Plan in particular, fully addressed the public's legitimate concerns. Id. at 203-04 (published opinion), 64, 67-70 (unpublished opinion).

Second, earnings analysis flies in the face of the economic and public policy objectives underlying price regulation. The incentive mechanisms which lie at the heart of price regulation -- and which deliver benefits to consumers in the form of improved efficiency, investment in the network, and innovation in services -- are based on the fact that there is no prescribed ceiling on earnings. (Am. Ill. Ex. 1.1, pp. 95-96; Am. Ill. Ex. 4.0, pp. 7-8, 15-16). By subjecting itself to price regulation, Ameritech Illinois assumed the risk of earning less than a "reasonable" return on equity and rate base, in exchange for the opportunity to earn in excess of what would typically be expected in a rate of return environment. This was fully understood in 1994. 1994 Order at pp. 7-12, 181-82. As Dr. Staranczak testified:

> "Under alternative regulation subscribers receive a guarantee that their overall rates will rise less than general inflation while Ameritech Illinois gets the opportunity to earn higher returns. If Ameritech does indeed earn higher returns under alternative regulation this should not be interpreted as a failure of the Plan but recognized as one of the possible outcomes that was anticipated." (Staff Ex. 2.0, pp. 4-5).

Indeed, there would have been no equitable or policy justification for the Commission to impose on Ameritech Illinois -- or for Ameritech Illinois to accept -- the downside risks of a price regulation plan if the upside potential were to last only until this review proceeding. (Am. Ill. Ex. 1.1, pp. 97-99).

GCI/City's only response to this issue is to congratulate themselves for not asking that prior earnings be returned to customers. (GCI/City Br. On Exc., p. 17-18, 52). This is hardly a concession on their part -- even under rate of return regulation, such refunds would be prohibited as retroactive ratemaking. Business and Professional People for the Public Interest v. Illinois Commerce Commission, 136 Ill. 2d 192, 229-30 (1989). The ability of the regulated company to retain earnings between rate proceedings is referred to as "regulatory lag", and is cited affirmatively by proponents of rate of return regulation as a source of efficiency incentives. As the Company demonstrated in testimony, the interval between 1994 and this proceeding is no improvement over what the Commission routinely applies to Illinois rate of return companies. (Am. Ill. Ex. 1.1, p. 68-70, 100, Sch. 4). The Commission rejected rate of return regulation in 1994 because, inter alia, it does not provide as effective operating incentives as price regulation.

In fact, price regulation coupled with intermittent earnings reviews would be even worse than rate of return regulation alone. Under this hybrid approach, the Company is required to reduce rates annually according to the price index -- something which no rate of return company must do -- and be subject to a general rate proceeding after five years. As a result, the anemic incentive effects of conventional regulatory lag are even further reduced. Moreover, Ameritech Illinois would have to bear the administrative and regulatory costs associated with both the annual price index filings and a general rate case. This would be more burdensome, not less burdensome, than rate of return regulation alone, where annual filing costs do not exist. Such a result is contrary to the objectives set forth in Section 13-506.1(a)(1). (Am. Ill. Ex. 1.1, pp. 68-70, 100). Nowhere do GCI/City provide any meaningful response to these deficiencies inherent in their approach.

GCI/City's argument that the earnings analysis must be performed for Ameritech Illinois' total intrastate operations is wrong as a matter of law. (GCI/City Br. on Exc., pp. 18-21). The reasonableness of Ameritech Illinois' competitive service rates is beyond the scope of this proceeding, which is directed at the performance of the Plan over its initial term. The Plan, both by its terms and by statute, is limited to noncompetitive services. (Am. Ill. Init. Br., pp. 20-22). GCI/City's citations to specific sections of Section 13-506.1 are unavailing. All of Section 13-506.1 follows prefatory language which authorizes the Commission to implement "alternative forms of regulation in order to establish just and reasonable rates for noncompetitive telecommunications services...." (emphasis added).

Ameritech Illinois does not dispute the fact that other provisions of the Public Utilities Act provide the Commission with "just and reasonable" authority over competitive service rates (i.e., Sections 9-250 and 13-505(b)). However, nothing in the Commission's 1994 Order remotely suggested that competitive service rates were to be the subject of this proceeding. Although GCI/City believe that Ameritech Illinois prematurely classified certain business services as competitive, that issue has become moot as a result of H.B. 2900.

Moreover, for services classified as competitive, the issue of "just and reasonable" rates is far more complex than the earnings review on which GCI is relying. Any regulatory restrictions on competitive service pricing should apply even-handedly to all providers of that service. (Am. Ill. Ex. 1.3, p. 33). This has been the Commission's practice to date. (Am. Ill. Ex. 1.4, p. 41). IXCs and CLECs have routinely been exempted from rate of return regulation in their certificate application proceedings. For example, in the 1987 certificate order for TRI-J Communications, the Commission stated as follows:

> "Applicant is a non-dominant telecommunications carrier and, as such, asks that it be exempted from 83 Ill. Adm. Code 250.10, 710 and 735. Concerning Part 710 (Uniform System of Accounts), the Commission notes that the Act indicates that rate base rate of return regulation is suitable only for those telecommunications carriers offering noncompetitive service. Both Part 710 and 735 (Credit, Billing, Deposits and Termination of Service) have been waived for many other telecommunications carriers

> including Allan. Similar waivers are also appropriate for TRI-J." Order in Docket 86-0373, adopted February 4, 1987, 1987 Ill. PUC LEXIS 34.

See also Order in Docket 93-0409 (MFS Intelenet of Illinois, Inc.), adopted July 20, 1994, 1994 Ill. PUC LEXIS 288; Order in Docket 95-0269 (LCI International Telecom Corp.), adopted January 10, 1996, 1996 Ill. PUC LEXIS 12; Order in Docket 95-0429 (Cable and Wireless, Inc.), adopted February 22, 1996, 1996 Ill. PUC LEXIS 84. Therefore, before embarking on any analysis of Ameritech Illinois' competitive service rates, the parties would have to address what standard other than earnings would be used to determine "just and reasonable" rates. Moreover, to establish industry-wide pricing rules, IXCs and CLECs would have to be provided notice and an opportunity to participate. No such notice was provided in connection with this proceeding.

Finally, even if competitive service rates were at issue in this proceeding -- which they are not -- there is no evidence that they warrant a $1 billion rate decrease. As CUB acknowledges, only "some" of them have been the subject of rate increases. (CUB Init. Br., p. 34). Ameritech Illinois believes that these rate changes were appropriate in the marketplace. (Am. Ill. Ex. 1.3, p. 143; Am. Ill. Ex. 1.4, p. 6). With respect to the remaining services whose rates have not changed, there is absolutely no evidence that their rates are too high. The mere fact that Ameritech Illinois' competitive services generate higher earnings than noncompetitive services reflects long-established pricing policies and says nothing about their reasonableness: they are competitive largely because they are profitable and profit margins attract competitors. (Am. Ill. Ex. 1.2, pp. 7, 17-18; Am. Ill. Ex. 1.3, pp. 69-70). Given the relatively poor returns generated by noncompetitive services (5.55% in 1994), Ameritech Illinois' financial viability has depended on and continues to depend on the fact that competitive services in aggregate earn substantially above average returns.

GCI/City contend that the Commission must analyze its total intrastate earnings because jointly used plant and common costs cannot be meaningfully allocated between competitive and noncompetitive services. (GCI/City Br. on Exc., p. 19). They are incorrect. Comparable allocations are performed every day in this industry. Jointly used plant and common costs have been separated between the state and interstate jurisdictions for ratemaking purposes for decades through the separations process. (Am. Ill. Ex. 1.4, pp. 37-41). Regulated costs are separated from unregulated costs to comply with the FCC's Part 64 requirements and Part 711 of this Commission's rules. Common costs are routinely allocated between competitive and noncompetitive services under the Aggregate Revenue Test to comply with Section 13-507 of the Act. Illinois Bell Telephone Company v. Illinois Commerce Commission, 203 Ill. App. 3d 424 (2nd Dist. 1990); Order in Docket 89-0033 (Remand), adopted November 4, 1991, at pp. 200-203. In fact, professional economists testifying in the 1994 proceeding, including the City's economic witness in this proceeding, Dr. Selwyn, proposed allocation methodologies to separate competitive and noncompetitive service earnings. (Am Ill. Ex. 1.3, pp. 24-25). The Company's analysis is based on essentially the same approach as the Aggregate Revenue Test and provides a valid basis for determining noncompetitive service earnings. (Am. Ill. Ex. 1.1, pp. 78-79; Am. Ill. Ex. 1.4, pp. 37-41). No party disputed the mechanics of this approach.[2]

Finally, GCI/City claim that they do not object to the Proposed Order's "zone of reasonableness" test -- just to the way in which it was applied. (GCI/City Br. on Exc., pp. 12,

[2] It is irrelevant what Ameritech Illinois representatives told Staff in December of 1999. (GCI/City Br. on Exc., p. 19). It is true that no off-the-shelf methodology exists which separates competitive from noncompetitive earnings. The analysis provided by Mr. Gebhardt was developed expressly for this proceeding and final results were not available until shortly before the filing of the Company's direct testimony on June 30, 2000. However, Staff and CUB have been on notice for several years that the Company would provide this analysis and make this argument, because Mr. Gebhardt provided a predecessor version in CUB's earnings complaint case (Docket 96-0178). At that time, Ameritech Illinois invited Staff to work with it in refining this methodology -- an invitation which Staff ignored. (Am. Ill. Ex. 1.3, pp. 21-22).

47). This is semantics on GCI/City's part. They have made clear throughout this proceeding that they view Ameritech Illinois' earnings as excessive if they exceed the low end of Staff's cost of capital analysis. That is the basis for their demand that rates be reduced by $956 million. They have never, ever, suggested that there was a "zone of reasonableness" around this number and they have provided no such zone in their Exceptions. According to GCI/City, fair, just and reasonable rates only result from traditional rate cases and the only reasonable level of earnings is one which would pass muster under traditional revenue requirements case law. Thus, GCI/City's approach to this issue is entirely circular and it cannot be squared with Section 13-506.1 or the Commission's objectives when it created the Plan in the first place. [3]

B. CHANGES IN TECHNOLOGY AND THE STRUCTURE OF THE TELECOMMUNICATION INDUSTRY

GCI/City contend that the Plan did not respond to changes in the industry which were, in fact, occurring because the residential local service marketplace is not yet fully competitive. (GCI/City Br. on Exc., pp. 21-22).

First, GCI/City are ignoring the dramatic changes which have taken place since 1994. Although they may not be satisfied with the pace of competitive entry, the market environment has clearly become more competitive. There are many more, and many more diverse, providers today than there were in 1994; and these competitors are successfully winning business from Ameritech Illinois. For example, in 1994, CLECs like MFS and TCG were just beginning to offer switched services to customers in Ameritech Illinois' service territory. Today, the Commission has certificated at least 59 CLECs, which collectively use a mix of resold services, UNEs and their own facilities to provide local exchange service. These CLECs include major

[3] Ameritech Illinois' reservations about this zone of reasonableness test have been validated by the GCI/City Brief on Exceptions. (Am. Ill. Br. on Exc., pp. 5-10).

IXCs like AT&T and MCI, fixed wireless competitors, cable companies and data CLECs. (Am. Ill. Ex. 4.0, pp. 19-20, 37-40). The scope of local competition has increased to the point where CLECs now have investments in place that can readily serve virtually all of Ameritech Illinois' business and residential customers. (Am. Ill. Ex. 4.0, pp. 17, 40-43).

There have also been significant changes in technology. An explosion in data traffic, driven in significant part by the Internet, is transforming the industry and requiring significant changes in Ameritech Illinois' network and network architecture. Traffic on the network has fundamentally shifted from voice to data, and Internet transactions are substituting for voice transactions. (Am. Ill. Ex. 4.0, pp. 23, 29-30). Wireless capacity has expanded rapidly and prices have declined substantially. As a result, customers increasingly substitute wireless for wireline calls. (Am. Ill. Ex. 4.0, pp. 30-33). Thus, the risks associated with marketplace dynamics which drove the adoption of price regulation in 1994 are even more compelling today. (Am. Ill. Ex. 1.1, pp. 8-10; Am. Ill. Ex. 4.0, pp. 17-45).

Second, GCI/City misperceive the Commission's expectations in 1994. The Commission adopted price regulation because it would adapt to marketplace changes over the long run -- not just those of the next five years. The Commission imposed a five-year rate cap on residential services because it assumed that residential local service would not become fully competitive and would not be subject to marketplace pricing constraints during this period. In fact, the Commission specifically stated that this rate cap would allow it to "grapple with the complex social and economic issues associated with new technologies and <u>emerging competition</u>" during this period. <u>1994 Order</u> at p. 65 (emphasis added). Thus, the fact that the marketplace is not yet fully competitive is not grounds for an adverse finding on this statutory standard.

C. EFFICIENCY GAINS AND COST SAVINGS

GCI/City contend that ratepayers did not appropriately benefit from the efficiency gains and cost savings which resulted from the Plan. (GCI/City Br. on Exc., p. 23). Their arguments, however, rest on a commingled view of noncompetitive and competitive service rate changes and earnings. This is improper. The Plan's performance has to be assessed in terms of the services to which it applied.

GCI/City also ignore the updated analysis which Ameritech Illinois provided of its own total factor productivity performance over the 1992-99 period. (Am. Ill. Ex. 2.1, p. 7; Am. Ill. Ex. 2.2, p. 5). This analysis was essentially identical in format and substance to the one the Commission used in 1994 to establish the X factor. Based on Ameritech Illinois TFP performance during the first term of the Plan, the X factor should have been 3.5% -- not 4.3%. The GCI witnesses raised no issues whatsoever relative to this Ameritech Illinois-specific study and it is uncontested in the record. Under these circumstances, it is entirely inappropriate for them to simply claim that the X factor was somehow insufficient. (See also GCI/City Br. on Exc., p. 7).

D. PREJUDICE OR DISADVANTAGE TO CUSTOMERS

GCI/City contend that Ameritech Illinois' decisions under the Plan to reduce usage rates have primarily benefited customers who make calls. (GCI/City Br. on Exc., pp. 23-24). GCI/City apparently would have preferred reductions in network access lines, which are subscribed to by customers who make little or no use of the network. The Company's pricing decisions do not constitute "prejudice" or "disadvantage". The Company made clear in 1994 that residential network access lines were underpriced and that it had no intention of reducing those rates under the Plan. 1994 Order at pp. 63, 68. As evidenced by the Company's rate rebalancing proposal, circumstances have not changed. The Company's consistent pricing policy over the last seven years relative to this issue has not been "prejudicial" within the meaning of the statute. In fact, a rate structure where a major service like residence network access lines is priced at or below cost, while customers of other services are expected to carry the entire burden of shared and common costs, is itself discriminatory. Finally, it was the Commission's intention to afford the Company a reasonable amount of discretion in deciding which rates to reduce within each basket; the fact that GCI/City would apparently have made different decisions does not mean that Ameritech Illinois was wrong. <u>1994 Order</u> at p. 70.

GCI/City's suggestion that every customer must benefit equally from the Plan to avoid prejudice and discrimination is nonsense. (GCI/City Br. on Exc., p. 24). Under Section 13-506.1(b)(7), the Plan may not reasonably prejudice or disadvantage "any particular <u>customer class</u>..." (emphasis added). Ameritech Illinois' individual consumers do not each equate to a "customer class". Moreover, even in contested rate design proceedings, there is no requirement that every customer benefit equally. Almost by definition, under any set of proposed rate changes, some customers benefit more than others (or, conversely, some customers are negatively impacted more than others). This is an inevitable consequence of the ratemaking process. GCI/City cite no case law which would support a finding that such an outcome constitutes discrimination.

E. <u>Competition</u>

GCI/City continue to argue that the Plan was under some obligation to promote competition and failed in this regard. For example, they conclude their argument on this issue as follows:

> "Further, effective competition for local service has not developed during the Plan, despite the legislative intent that the development of competition

> be a consideration in the adoption of alternative regulation." (GCI/City Br. on Exc., pp. 30-31).

As the Proposed Order concludes, GCI/City are once again misstating the statutory purpose of Section 13-506.1 and the Commission's intent in 1994. Under Section 13-103(b), the Commission must consider whether any alternative regulation plan will promote the legislative goal of allowing competition to substitute for certain aspects of regulation, where consistent with the protection of consumers. In its 1994 Order, the Commission concluded that the Plan would further this goal, because price regulation better reflects the operating freedoms and constraints faced by competitive companies and reduces the economic burden of regulation generally. 1994 Order at p. 184. The Plan has met the Commission's expectations because it eliminated unnecessary regulatory oversight and constraints. However, beyond this, price regulation is fundamentally a retail plan: it governs the pricing of Ameritech Illinois' noncompetitive services to consumers and it establishes the governance structure relative to retail service quality, network investment and financial performance. It is not a wholesale plan. Thus, price regulation plans do not themselves either encourage or discourage the development of competition, except to the extent they result in more efficient price signals to potential competitors.

GCI/City object to the proposed Order's characterization of its position that the Plan should have, but did not, promote competition. (GCI/City Br. on Exc., pp. 24-26). In fact, the Proposed Order describes their position accurately and it should not be changed. (See, e.g., City Init. Br., pp. 14-16; CUB Init. Br., p. 35). GCI/City then go on to restate their argument, contending that competition should have, but did not, replace the need for regulation to restrain prices:

> "In actuality, GCI/City argued that despite the Commission's intention that competition replace regulation, competition has not developed to the point where it can constrain prices....Therefore, the question before the

> Commission is whether competition has developed to the extent that it can substitute for regulation 'consistent with the protection of consumers'." (GCI/City Br. on Exc., p. 25).

The difference between these two positions is less than clear.

Even with their argument restated, however, GCI/City are missing the point of price regulation. Ameritech Illinois' noncompetitive services are subject to the Plan precisely because competition has not developed to the point where it can constrain prices. If price constraining competition had developed over the last six years for these services, the proper regulatory response would be deregulation (not reclassification as competitive services), and there would be no role for the Plan at all. (Am. Ill. Ex. 4.2, p. 20; Am. Ill. Ex. 4.3, p. 29). In fact, as the Company pointed out, the pioneering work on the merits of price regulation assumed a monopoly environment; economists and regulators only later came to the realization that it offered unique advantages in markets transitioning to competition. (Am. Ill. Ex. 4.2, pp. 18-19). Therefore, it is irrelevant to the analysis whether 6% or 60% of Ameritech Illinois' customers are served today by CLECs. The Plan will ensure that noncompetitive service prices are appropriately constrained for customers who do not yet have competitive alternatives.[4]

III. GOING FORWARD MODIFICATIONS TO THE PLAN

A. ONLY MINOR MODIFICATIONS ARE REQUIRED TO THE PRICE INDEX

1. The X Factor

GCI/City contend that the Proposed Order erred in adopting the industry TFP analysis supported by Ameritech Illinois and Staff and rejecting the FCC's X factor of 6.5%. (GCI/City Br. on Exc., pp. 29-31). GCI/City contend that the FCC's 6.5% offset is a productivity factor

[4] To the extent that GCI/City are contending that competitive service prices have not been constrained adequately by the marketplace, that is not a failing of the Plan. Furthermore, price increases for competitive services will attract competitors, not discourage them. The marketplace will ultimately police itself.

and that it was agreed to by SBC and other ILECs as a productivity factor. GCI/City are incorrect.

The FCC's 6.5% X factor was part of the CALLS proposal and represented a comprehensive settlement of many outstanding issues at the federal level. The FCC's Orders make clear that it is a "ramp-down method" of achieving certain FCC pricing objectives and that it will disappear when the FCC's target is achieved, hardly the mark of a conventional X factor. (Am. Ill. Ex. 2.2, pp. 18-19; Am. Ill. Ex. 2.3, pp. 9-10). GCI/City attempt to side-step these uncontroverted facts by claiming that the "label" attached to the 6.5% offset is irrelevant. This is not a matter of "labeling". The FCC's X factor now serves an entirely different purpose at the federal level than the X factor which is being adopted in this proceeding. Moreover, the FCC's prior efforts to establish a true X factor were riddled with flaws, as both Ameritech Illinois and Staff agreed. (Am. Ill. Init. Br., pp. 39-40; Staff Reply Br., p. 17). This Commission is not free to adopt ratemaking tools from other jurisdictions without substantial evidence in <u>this</u> record supporting their use. <u>Union Elec. Co. v. Ill. Commerce Commission</u>, 77 Ill. 2d 364, 383 (1979). No such record exists here.

GCI/City rely on Dr. Selwyn's so-called "implied X factor analysis" to claim that a high X factor should be used. (GCI/City Br. on Exc., p. 30). However, this is not an analysis of TFP. It is simply reverse engineering of Ameritech Illinois' 1999 total company earnings. Not even Dr. Selwyn claimed that it could or should be used to establish an X factor. (GCI Ex. 3.0, p. 26). This argument is nothing more than GCI's earnings claims in a different guise. (Am. Ill. Ex. 1.3, pp. 78-79).

2. <u>The Exogenous Change Factor</u>

The Proposed Order adopted Ameritech Illinois' proposal that it be allowed to offset Commission-mandated rate reductions on an expedited basis. GCI/City and AT&T contend that the Proposed Order is confused and requires clarification. (GCI/City Br. on Exc., pp. 31-32; AT&T Br. on Exc., pp. 2-4). Ameritech Illinois agrees that the text of the Proposed Order could be clearer, but the substance of its conclusions should not be changed.

First, Ameritech Illinois only requested expedited treatment of Commission-mandated rate reductions and it was this proposal which Staff suggested be implemented through 30-day filings. Therefore, the last sentence of the first paragraph of the Commission Analysis and Conclusion should be modified as follows:

> "The Commission is persuaded by Staff's proposal which would allow AI to make an exogenous treatment filing within 30 days of a Commission-mandated rate reduction, together with the specific rates it wishes to change."

Since significant, Commission-mandated rate reductions occur very infrequently, the parade of administrative "horribles" cited by GCI/City and AT&T is over-stated and the process should be perfectly workable in reality. (GCI/City Br. On Exc., pp. 31-32; AT&T Br. on Exc., pp. 3-4).[5]

GCI/City's objections to the Proposed Order's statement that it would be arbitrary and inconsistent to "automatically prohibit exogenous treatment for Commission mandated rate reductions" misperceives its purpose. (Id., p. 32). The Proposed Order was not describing existing Commission's policy. The Company asked for clarification precisely because the issue has not been addressed yet. The Proposed Order was describing the arguments which GCI/City have made with respect to exogenous treatment of Commission-mandated rate reductions, which have bordered on precisely this position: i.e., that Ameritech Illinois should be prohibited from offsetting rate reductions through the Z factor. (See, e.g., AG Init. Br., pp. 62-63; CUB Init. Br., pp. 56-59).

[5] The access charge reductions mandated in Dockets 97-0601/0602/0516 is the only candidate for Z factor treatment which occurred during the first term of the Plan.

GCI/City's argument that Ameritech Illinois is trying to deny the Commission "discretion" is incorrect. (GCI/City Br. on Exc., p. 32). Based on past experience, the Company recognizes that Z factor treatment is never automatic. Rather, the Company is seeking explicit recognition that Commission-mandated rate reductions may be the subject of an exogenous change request. Whether or not that request would be granted is a subject for the filing in which it is made. However, Staff testified that Z factor treatment should be denied only under extraordinary circumstances. (Tr. 1276-77).

Finally, GCI/City criticize the Company for attempting to use exogenous change factor treatment to maintain "revenue neutrality" under the price index -- a concept they claim is "associated with rate of return regulation". (GCI/City Br. on Exc., p. 32). They misunderstand price regulation. The Company's aggregate noncompetitive revenue levels are governed by a price index, which dictates the extent to which noncompetitive revenues should be increased or decreased based on cost changes in the economy. This process bounds Ameritech Illinois' price change obligations relative to its noncompetitive services as a whole. The Commission may order decreases in individual service rates (e.g., access charges) to achieve other ratemaking objectives while the Plan is in effect. However, unless and until the Commission develops a new X factor based on substantial evidence, such rate actions should not change the Company's overall noncompetitive revenue levels. This is a matter of maintaining the integrity of the price index and fairness to the Company. (Tr. 1276-77).

B. PRICING FLEXIBILITY SHOULD BE INCREASED, NOT DECREASED

GCI/City take the position that the Proposed Order erred in not reinstituting a rate cap on a going-forward basis. (GCI/City Br. on Exc., pp. 33-37, 82-83). Such a cap should not be adopted and the Proposed Order should not be changed in this regard.

GCI/City's contention that another rate cap on basic residential services is required as a matter of law under Section 13-506.1(c) is incorrect. They argue that whatever emerges from this proceeding constitutes a "new" plan, which triggers the 180-day rule in Section 13-506.1(c): i.e., that for the next three years, basic residential rates cannot be higher than the rates in effect over the last 180 days. Thus, as GCI/City point out, even the meager 2% rate flexibility offered under the Plan would not be usable under this interpretation.

Absolutely nothing in Section 13-506.1(c) supports this novel interpretation of the statute. Section 13-506.1(c) by its terms is triggered once, and only once, when the regulated company first files for approval of a plan of alternative regulation:

> "An alternative regulation plan approved under this Section shall provide, as a condition for Commission approval of the plan, that for the first 3 years the plan is in effect, basic residence rates shall be no higher than those rates in effect 180 days before the filing of the plan" (emphasis added).

Ameritech Illinois did not "file a plan" in this proceeding. It already has a plan in effect. Even if the Commission authorizes changes in that Plan, they would constitute modifications to an existing plan, not a new plan. Moreover, the rate cap applies only during the "first 3 years" that a plan is in effect. Ameritech Illinois' Plan has now been in effect for over seven years. Under accepted canons of statutory construction, statutory provisions are to be interpreted in light of their "plain meaning" and Section 13-506.1(c), by its terms, does not apply here. Bruso v. Alexian Brothers Hospital, 178 Ill. 2d 445, 451-52 (1977).

GCI/City contend that the Appellate Court's reference to "any plan" in the appeal from the Commission's 1994 Order means that Section 13-506.1(c) is triggered by this review proceeding. (GCI/City Br. on Exc., p. 34). GCI/City are incorrect. At issue in the portion of the Opinion to which GCI/City cite was CUB's claim that Section 13-506.1 was an impermissibly vague delegation of authority to the Commission by the legislature. The Appellate Court recited the various statutory standards and safeguards that apply when the Commission approves "any plan" only in support of a conclusion that these standards were "sufficiently precise" to pass constitutional muster, not as part of a determination of <u>when</u> they were triggered. Moreover, this discussion occurred in the context of an unambiguously new plan which had just been approved by the Commission. No party even raised on appeal the issue whether Section 13-506.1(c) applied if the Commission were to review an existing plan. Thus, GCI/City are manufacturing legal support where there is none.

From a policy perspective, the interpretation advanced by GCI/City is unwise, because it would deprive the Commission of far more ratemaking authority than the legislature intended. By capping rates in the Residence basket for only five years in 1994 and providing for this review proceeding, the Commission clearly intended to revisit the rate cap issue. However, according to GCI/City, the price of making <u>any</u> changes to the Plan in this docket is another three-year rate freeze -- whether or not the Commission believes it to be appropriate, whether or not residential network access line rates are properly priced, and whether or not competition would be harmed. This would constitute a 10-year freeze period (1994-2004). If the legislature had wanted basic residential rates to be capped for 10 years, it would have said so.

GCI/City contend that the same considerations which led the Commission to impose a rate cap in 1994 continue to apply in 2001. (GCI/City Br. on Exc., p. 35). They are incorrect. Although GCI/City express dissatisfaction with the pace of residential competition to date, circumstances have changed and will continue to change significantly over the next several years. CLECs have already evidenced renewed interest in the residential marketplace, line losses to competitors are growing and Ameritech Illinois' entry into the long distance business will stimulate CLEC marketing activities -- entry which will surely be approved in the foreseeable future. (Am. Ill. Ex. 1.4, p. 65). The Commission's experience with the Plan over the last seven years demonstrates that very limited price changes can be made under the price index, with or without a rate cap, and that inappropriate pricing proposals can be addressed in the annual price cap filing process. It should be further noted that Staff is not proposing continuation of the rate cap. (Tr. 611). In short, a continued rate cap imposes unnecessarily rigid pricing constraints on both the Commission and the Company, and it is not required to meet the statutory objectives set out in Section 13-506.1.

C. A MERGER SAVINGS ADJUSTMENT SHOULD NOT BE MADE NOW

GCI/City take exception to the Proposed Order's decision to reject the adoption of the "M-factor" to reflect merger savings, as proposed by Dr. Selwyn. (GCI/City Br. on Exc., pp. 37-39). GCI/City assert that adoption of that "M factor" will "ensure that ratepayers receive their share of merger savings in a timely fashion." (Id., p. 39). This assertion is wrong. As the Proposed Order correctly stated, the Order in Docket 98-0555 is clear that customers' share of merger savings is to be determined on the basis of actual data regarding merger-related costs and savings, not estimates. Dr. Selwyn's proposed M factor is based on the same fictional estimate of merger savings that he presented, and which the Commission rejected, in Docket 98-0555. Order in Docket 98-0555, adopted Sept. 23, 1999, at p. 147. Accordingly, GCI/City's Exceptions on this issue should be rejected.

In its Brief on Exceptions, Staff concurs with the Proposed Order's approach of continuing to conduct annual audits of merger-related savings until SBC/Ameritech achieve a going level of net savings. Staff, however, proposes to modify the Proposed Order to reflect Staff's belief that the going level of savings will not be achieved before 2004. (Staff Br. on Exc., pp. 27-29). As the Company discussed in its Brief on Exceptions, the evidence shows that the going level of savings may be achieved as early as 2002. (Am. Ill. Init. Br., p. 18; Am. Ill. Ex. 3.3, p. 8). Moreover, the Company does not believe that it is necessary for the Commission, at this time, to predict exactly when the going level of savings will be achieved. Instead, the Company recommends that, on an interim basis, actual merger costs and savings continue to be examined and dealt with annually and that the permanent solution be deferred to another proceeding. Under the Company's recommended approach, the Commission would retain the flexibility to develop and implement a permanent solution to the regulatory treatment of merger savings prior to the year 2004, if appropriate. Language implementing this approach was set forth in the Company's Exceptions. (Am. Ill. Ex., p. 20).

D. MODIFICATIONS SHOULD NOT BE MADE TO THE TREATMENT OF OPTIONAL CALLING PLANS

Both Staff and GCI/City except to the Proposed Order's conclusion that optional calling plans should be defined as new services and should be treated as such for purposes of basket assignments. Under the Plan, new services are not subject to the index for one year, so that the Company can develop demand information necessary to set the API; and they are assigned to the "Other" basket once they become subject to the Plan. Staff and GCI/City object to the fact that optional calling plans (e.g., CallPak and SimpliFive) which offer customers new pricing alternatives have been assigned to the Other basket. (Staff Br. on Exc., pp. 2-3; GCI/City Br. on Exc., pp. 39-40). The Proposed Order properly concluded that new services should be defined to include both new capabilities and new pricing options and that calling plans which are optional are properly assigned to the Other basket. (HEPO, Section V, E, 2, b, Commission Analysis and Conclusion).

Staff takes the position that, because local usage is an essential service, any calling plan which in any way involves usage must be equally essential, must be subject to the strictest of pricing rules and must be assigned to the Residence basket. (Staff Br. on Exc., p. 2). Staff's approach is far too rigid and is not workable in a marketplace which will be increasingly characterized by a range of pricing alternatives.

The Commission imposed strict pricing limits on essential calling services in 1994. By placing standard tariffed rates for Bands A and B usage in the Residence basket, the Commission ensured that residence customers will always have this basic service option available to them at a price which has been subject to the index protections since the outset of the Plan.

This does not mean, however, that every calling plan must be treated as an existing service and be subject to those constraints when first offered. Staff claims that Ameritech Illinois' position on calling plans is analogous to "telling diabetics that they have an option regarding whether or not they purchase insulin". (Staff Br. on Exc., p. 2). This is nonsense. Under Ameritech Illinois' approach, customers are not faced with the choice of buying usage under an optional calling plan or making no calls at all. Basic usage services at standard tariffed rates are also available. Pricing alternatives for those services should be treated as new services precisely because they are new, because customers have complete discretion whether or not to select them and because customers will select them only if they obtain pricing or other advantages. A better analogy (albeit imperfect) would be to a hypothetical government program which placed strict price controls on bread, but allowed bakers to establish the going-in prices of croissants, bagels, muffins, scones and buns before subjecting them to controls. Although all of these products are substitutable at some level of analysis, the compelling public policy rationale for the strictest price controls applies only to the basic bread product. Customers should be permitted to make their own decisions about whether to purchase alternatives at the prices at which they are offered.

Staff further contends that both CallPak 100 and SimpliFive should be assigned to the Residence basket because "the Commission found in Docket No. 00-0043 that Ameritech significantly misled customers about their 'options'". (Id., p. 2). This is a non sequitur, as well as being inaccurate. There is no logical connection between the Company's marketing practices and the issue of whether these services are optional. The fact the Company marketed them at all underscores the fact that customers had a choice. Moreover, in Docket 00-0043, the Commission only found problems in the Company's marketing of SimpliFive. Order in Docket No. 00-0043, adopted January 23, 2001. Under this Staff theory, SimpliFive would be assigned to the Residence basket and CallPak 100 would be assigned to the Other basket. This is nonsensical.

Staff suggests that calling plan customers are disadvantaged when the plans are placed in the Other basket and "the benefits of efficiency are passed on by the Company". (Staff Br. on Exc., p. 2). Staff's argument is confused. First, customers selecting optional calling plans typically do so because they save money, in some cases quite a lot of money. Second, the fact that they are assigned to the Other basket after one year means that the index is fully applicable at that time. The Residence and Other baskets are both subject to the same API/PCI constraints and "improved efficiency" under the Plan flows through to these two baskets in precisely the same manner.

GCI/City also contend that the prices in any new, optional calling plans must be subject to the constraints imposed by the Commission in 1994. (GCI/City Br. on Exc., pp. 39-41). Although they are circumspect in their Brief on Exceptions as to the implications of this approach, CUB admitted forthrightly in its Initial Brief that Ameritech Illinois would have been "prohibited" from offering these calling plans at all if they were treated as existing services.

Ameritech Illinois is at a loss to understand who would benefit by defining "new services" in this way. The Company should be permitted to offer innovative calling plans. As the Company demonstrated in Docket 00-0043, customers liked these plans and, as a whole, saved many millions of dollars.[6] As long as they are marketed appropriately, there is no policy reason to prohibit them and CUB made no such request in Docket 00-0043. CUB is apparently trying to use the "new services" definition as a back-door mechanism to accomplish what it never asked the Commission to do directly. This tactic is improper and should be rejected.

As a separate exception, Staff proposes that the new flat rate calling plans mandated by H.B. 2900 be assigned in this proceeding to the Residence basket. (Staff Br. on Exc., pp. 36-37). The Company agrees that these plans should be the subject of separate analysis, in view of the fact that they are legislatively mandated and represent a significant change in the Company's usage rate structure. In other words, the fact that SimpliFive and CallPak 100 were and should have been considered new services under the Plan does not dictate how these flat rate plans will be treated. However, the Company believes that it is premature to reach any conclusion at this time. The issue should be deferred until Ameritech Illinois has developed tariffs, the Commission has reviewed them and all parties have had an opportunity to address the issue. The Company further notes that combining the Residence and Other baskets would eliminate these

---

[6] Thus, GCI/City's claim that the Company used these services "to generate additional revenue above what the Plan would have allowed" is highly misleading. To achieve a simplified rate structure, some prices in these plans are higher than the standard tariffed rates and some are lower. For example, under CallPak 100, all Bands A, B and C calls are priced at 10¢ per call. Although Band A prices are higher than standard tariffed rates, customers can save substantial amounts of money on Bands B and C calls, which are subject to per minute prices. Under SimpliFive, Band A calls are priced at 5¢ per minute. Customers with relatively heavy band C calling patterns can and do save money. It was undisputed in Docket 00-0043 that Ameritech Illinois' overall usage revenues were much lower than they would have been absent these plans.

issues entirely.

E. <u>THE API/PCI SHOULD NOT BE REINITIALIZED</u>

Staff, GCI/City and AT&T except to the Proposed Order's conclusion that the API/PCI for each basket should not be reinitialized to 100 as an adjustment going into the next term of the Plan. (Staff Br. on Exc., pp. 3-6; GCI/City Br. on Exc., p. 41; AT&T Br. on Exc., pp. 6-7). Reinitialization would remove the "headroom" which has developed in the Carrier basket, where rates have declined more than the price index would have required.[7] As the Proposed Order properly concludes, this headroom should not be eliminated. (HEPO, Section IV, E, 2, d, Commission Analysis and Conclusion).

Staff contends that the headroom in the Carrier basket is an "anomaly" resulting from past rate orders, which allows Ameritech Illinois to "evade rate reductions for services in the Plan on an annual basis". (Staff Br. on Exc., p.4). Staff's position reflects a complete misunderstanding of the purpose of the price index. The index was never intended to require year-over-year rate reductions, regardless whether reductions are needed to keep rates under the PCI. As a result of FCC and ICC-mandated rate reductions, rates in the Carrier basket are now far below the level which otherwise would have been required by the index. In the most recent annual price cap filing, the new API's for the Residence, Carrier and Other baskets are as follows:

Residence Services	85.0197
Carrier Basket	57.6025
Other Services	85.0181[8]

These data demonstrate that carrier customers have received massive rate benefits over

---

[7] Although there is also a smaller amount of headroom in the Business basket, there will be no Business basket once H.B. 2900 becomes law.

[8] <u>Proposed Order in Docket 01-0302</u>, dated June 1, 2001, at p. 8, administrative notice requested.

the last few years which dwarf the impact of the Plan on Residence and Other rates. There is a spread of over 27 percentage points between the Carrier basket and the Residence/Other baskets. In contrast, the PCI typically declines about 2-3 percentage points year-over-year. (Tr. 2114). In other words, IXCs subscribing to carrier access charges have already received an advance on years and years worth of efficiency gains; they just obtained these benefits up front through FCC and ICC rate orders, instead of gradually in annual price cap filings over the next term of the Plan. There is absolutely no logic to reinitializing the Carrier basket API to 100, thus requiring future rate reductions on a year-to-year basis. Staff could not articulate any policy basis for further advantaging the IXCs in cross-examination and Staff's Brief on Exceptions contains none.[9] (Tr. 592-93).

Staff and GCI/City raise the spectre of Ameritech Illinois attempting to offset this Carrier headroom with increases in other carrier rates. (Staff Br. on Exc., pp. 3-4; GCI/City Br. on Exc., p. 41). This has no basis in fact. There are no services of any consequence in the carrier basket whose rates could be increased: wholesale (resale) prices are established by rate formulas that cannot be changed absent another wholesale(resale) pricing proceeding and carrier access rates are subject to the pricing rules established in Dockets 97-0601/0602/0516. Contrary to Staff's representation, the Company's objective here is not to raise carrier rates. Ameritech Illinois' objective is to avoid having to reduce carrier access rates even further than what was ordered in Dockets 97-0601/0602/0516, merely as a function of the price index and not based on a demonstration that its LRSIC costs incurred to provide carrier access services (including a reasonable allocation of shared and common costs) have declined.

---

[9] Under Section 13-506.1(b)(7), the Plan may not unreasonably disadvantage any customer class. An argument could be made that reinitializing the API in the Carrier basket would unreasonably advantage carriers and disadvantage other customer groups.

Finally, if the Commission requires the inclusion of UNEs in the carrier basket -- which it should not -- Ameritech Illinois does not agree that the Commission should use the methodology proposed by Staff. This methodology was developed by the Company to permit basket consolidation, where all services have an API. By definition, services outside the index have no API associated with them. Thus, this methodology cannot be applied to the addition of discrete services/functionalities without further analysis. Moreover, practices have already been developed to address service removals, because of service reclassifications or for other reasons. Symmetry would be required to avoid distorting the operation of the index. In short, the record simply does not exist in this proceeding to determine whether or how the Carrier basket API should be adjusted.

F. ONE-TIME CREDITS OR REFUNDS SHOULD NOT BE MADE[10]

Staff takes exception to the Proposed Order's rejection of Staff's proposal for a one-time rate reduction of $29.5 million, based on its argument that Ameritech Illinois has failed to meet the Plan's benchmark for Installation within Five Days. (Staff Br. on Exc., pp. 10, 12). As Ameritech Illinois explains below, in its discussion of that benchmark, Staff's exception should be rejected.

G. IMPROPER RECLASSIFICATION PENALTIES SHOULD NOT BE ADOPTED

GCI/City, Staff and AT&T all take exception to the Proposed Order's decision to reject GCI/City's proposal that Ameritech Illinois be assessed a penalty of $10,000 per day for any competitive service classification which the Commission ultimately concludes was inappropriate after contested hearings. (GCI/City Br. on Exc., pp. 42-43; Staff Br. on Exc., pp. 7-9; AT&T Br.

[10] Although Staff proposed two one-time credit or refunds, it has not excepted to the Proposed Order's treatment of the refunds allegedly due to the premature reclassification of certain residence services as competitive.

on Exc., pp. 7-8). This proposal was properly rejected by the Proposed Order, and the Exceptions of GCI/City, Staff and AT&T should be rejected.

As the Company discussed in its Initial Brief, reclassification penalties are completely unreasonable as a matter of regulatory policy. (Am. Ill. Init. Br., pp. 51-52). The fact that there are sometimes disputes over the appropriate classification of services (as there were in Docket 98-0860) is not a basis for punishing the Company, as GCI/City, Staff and AT&T propose. As Staff witness Staranczak testified:

> "The Company [in Docket 98-0860] did not act illegally by having the services declared competitive. Moreover, the criteria for classifying services as competitive were not established by AI but by the legislature." (Staff Ex. 2.0, p. 5).

There is absolutely no evidence in the record that Ameritech Illinois has ever acted in bad faith with respect to the classification of services as competitive. In fact, more competitive classifications have been approved than rejected by the Commission over the last several years. (Am. Ill. Ex. 1.3, pp. 29-30; Am. Ill. Ex. 1.4, pp. 42-43.)

As the Company also discussed in its Initial Brief, nothing in the Public Utilities Act permits the Commission to impose penalties in this situation. (Am. Ill. Init. Br., pp. 52-53). This Commission's powers and authority are defined by the terms of the Public Utilities Act. Business and Professional People for the Public Interest v. Illinois Commerce Commission, 136 Ill. 2d 192, 201, 240 (1989). AT&T asserts that H. B. 2900 "gives the Commission express statutory authority to impose penalties, including penalties for improper reclassification." (AT&T Br. on Exc., pp. 7-8). AT&T, however, fails to cite any provision of H.B. 2900 which supports its assertion. Under H.B. 2900, the Commission's authority to impose penalties is limited by Sections 13-305 and 13-516. Section 13-305 (like existing Section 5-202 of the

Public Utilities Act) authorizes the Commission to assess civil penalties for failure to comply with the Act or to obey a Commission order or rule. Section 13-516 allows sanctions for violations of Section 13-514 of the Act. Neither Section 13-305 nor 13-516, however, would permit the imposition of penalties just because the Commission disagrees with a service reclassification on its merits.[11]

In addition, the law disfavors penalties in the absence of demonstrable bad faith, intentional wrongdoing or other comparable conduct, as being violative of due process. Southwestern Telegraph and Telephone Co. v. Danaher, 238 U.S. 482 (1915). Furthermore, Section 13-502(e) already provides mechanisms to ensure that the Company does not profit from, and customers are not harmed by, classifications that are later overturned: the Commission has the authority to require that rates be returned to their pre-reclassification level and that any rate increases be refunded to customers. (Am. Ill. Ex. 1.4, p. 43). In this regard, it should be noted that, although H.B. 2900 contains amendments to Section 13-502 (which governs classification of services) and adds Section 13-502.5 (entitled "Services alleged to be improperly classified"), the General Assembly did not incorporate into either Section language authorizing the Commission to impose a penalty of the type proposed by GCI/City. This fact further supports the conclusion that the Commission lacks the authority to impose such a penalty.

Finally, GCI/City's reclassification penalty proposal is outside the scope of this proceeding, which was initiated to review the functioning of the Plan under Section 13-506.1.

[11] Even if Section 13-305 could be interpreted as providing the Commission with authority to impose upon Ameritech Illinois a penalty for losing a contested dispute over the competitive classification of a service (and it cannot be), that legislation would clearly not support AT&T's proposed finding that Ameritech Illinois should "be required to pay the maximum penalty allowable under House Bill 2900." (AT&T Br. on Exc., p. 8). Section 13-304 provides that civil penalties authorized by Section 13-305 may be assessed only after notice and opportunity to be heard. Section 13-304 further provides the Commission with authority to impose less than the maximum penalty based upon a consideration of mitigating factors including, but not limited to, the respondent's due diligence in attempting to comply with the requirements of the Act or Commission orders and rules, or to secure lawful relief from those requirements.

Section 13-506.1 has nothing whatsoever to do with competitive service reclassifications, which are governed by Section 13-502.

H. Rate Reinitialization Should Not Be Adopted

Just as they objected to the Proposed Order's approach to just and reasonable rates under Section 13-506.1(b) of the Act, GCI/City insist that the Proposed Order is wrong when it rejects their proposal to reinitialize Ameritech Illinois' rates based on a traditional, rate case analysis. Fundamentally, GCI/City cannot accept the fact that the Commission's decision to adopt price regulation in 1994 represented a change in regulatory models, not just an additional layer of regulation on top of rate of return regulation. The Proposed Order is correct in its analyses and this analysis should be adopted by the Commission.[12]

GCI/City contend that Section 13-506.1 of the Act, the Commission's 1994 Order and the Appellate Court's decision on appeal from that Order require a traditional, rate case examination of earnings in this review proceeding. (GCI/City Br. on Exc., p. 44). This is simply not the case, for all the reasons discussed infra relative to the just and reasonable rate standard. Contrary to GCI/City's claim, the fact that Section 13-506.1(f) provides that Sections 9-241, 9-250 and 13-505.2 remain applicable to noncompetitive services has no bearing on this issue. Those three sections of the Act impose nondiscrimination obligations on Ameritech Illinois. GCI/City have not articulated any theory under which application or nonapplication of an earnings review in this proceeding would constitute discrimination within the meaning of those statutory provisions.

Similarly, the fact that the Appellate Court may have described Section 13-506.1 as a "tool to move the telecommunications industry from monopoly to market" says nothing about

[12] As discussed in Ameritech Illinois' Brief on Exceptions and Exceptions, the Company does not support use of a "zone of reasonableness" test in connection with either an analysis of just and reasonable rates or rate reinitialization. (Am. Ill. Br. on Exc., pp. 5-10; Am. Ill. Ex., pp. 6-8, 25). Therefore, the Company will not address GCI/City's arguments relative to that issue.

how to define just and reasonable rates. (GCI/City Br. on Exc., p. 44). As Ameritech Illinois has stated on numerous occasions, this Plan was never intended as a tool to create competition, nor is a competitive local marketplace required today to retain it. The Plan was intended to allow Ameritech Illinois to prepare itself for competition; to protect consumers over the long run from the downside effects of competition and technological change, as the industry and the marketplace evolve; and to ensure that noncompetitive rates remain reasonable during the transition period. GCI/City's continuing insistence that the Plan can only work properly in a competitive marketplace is a strawman and nothing more.

GCI/City's argument that a rate case is required because "much has changed since 1994" reflects a profound misunderstanding of the Commission's purpose in adopting price regulation. (GCI/City Br. on Exc., pp. 45-46). Of course things have changed. It was to protect consumers against all of the potential downside risks of those changes that the Commission replaced rate of return regulation with the Plan. GCI/City are insisting on rate reinitialization in this case only because Ameritech Illinois earned well during this period. The Company has suggested on several occasions during this proceeding that, had the economy been less robust, had Ameritech Illinois' revenues eroded more than they did, had the Company made mistakes relative to technology or the marketplace, GCI/City would be insisting that the Company live with the financial consequences of the regulatory bargain it entered into in 1994. (Am. Ill. Ex. 1.3, pp. 68-69; Am. Ill. Ex. 1.4, p. 55). GCI/City has never denied this. Thus, GCI/City's view of what is "just and reasonable" is entirely one-sided and does not reflect the complex and balanced trade-off of risks and rewards which the Commission made in 1994.[13]

GCI/City's citations to the Commission's 1994 Order do not support their position either. (GCI/City Br. on Exc., p. 46). GCI/City claims that the following quotation stands for the proposition that the Commission intended to examine the Company's earnings in the future:

> "(t)he Company should not interpret our endorsement of an alternative regulation plan as an abandonment of our long-standing commitment to marginal cost-based prices. The Commission wishes to make clear that by approving an alternative regulation plan, we will not abdicate our responsibility to scrutinize the pricing practices of the Company, and we will suspend proposed price changes where warranted, even if the proposed price changes are in technical compliance with the price regulation formula." (GCI/City Br. on Exc., p. 46).

This is a statement that the Commission will follow an economically-based (i.e., "marginal-cost based") rate design policy when evaluating individual rate changes within the context of the Plan. It has nothing whatsoever to do with earnings or the use of rate case analysis to reinitialize the Company rates. In fact, an examination of the Company's revenues, expenses and rate base based on its books of account is the conceptual antithesis of marginal-cost based pricing. GCI/City's reference to the Commission's statement that earnings can be an "early warning" that the price regulation formula has been misspecified has no bearing on a proceeding such as this one, where every element of the index and pricing under the index has been reviewed in exhaustive detail. (Am. Ill. Br. on Exc., p. 8). Similarly, the Commission's stated willingness in

13 GCI/City's specific list of what has changed further demonstrates their misunderstanding of price regulation. Their first item, "declining cost trends in the telecommunications industry", is captured in the analyses which support the X factor: declining per unit prices are reflected in the input price growth factor and increased output in the TFP studies. (Am. Ill. Ex. 2.0, pp. 2-4). With respect to their second item, "increased access line growth and unprecedented demand for vertical features", Ameritech Illinois is entitled to retain the benefits of its sales and marketing efforts, just as it bears the burden if demand falls off. The last item, service quality issues, is entirely separate from how to define just and reasonable rates and is dealt with appropriately in the Proposed Order.

1994 to revisit earnings sharing in this proceeding says nothing about whether rates would be reinitialized based on a rate case analysis.[14]

GCI/City contends that the Proposed Order may have improperly shifted the burden of proof on this issue to the Intervenors. (GCI/City Br. on Exc., p. 51). The Proposed Order stated as follows:

> "There is no showing that rates are unfair, unjust or unreasonable through any type of reasoned analysis. We are only presented with the proposition that earnings are higher than initially authorized and hence rates must be unreasonable."

GCI/City are incorrect. Ameritech Illinois met its burden of proof. It demonstrated that its noncompetitive rates are just and reasonable based both on a straightforward analysis of their price performance under the index and based on an affordability analysis. (Am. Ill. Ex. 1.1, pp. 13-14, 29-30, 68, 72-73). Staff agreed that price performance was the correct analytical model and that the Company's rates were just and reasonable under that model. (Staff Ex. 1.0, p. 24; Tr. 1192-93, 1217, 1223-26, 1249-54). What the Proposed Order intended by this statement was that GCI/City had the obligation of any party presenting a position to provide a "reasoned" basis for their position. Finding GCI/City's rate case-based definition of just and reasonable rates deficient on all scores, based on the evidence in the record, does not constitute a shift in the burden of proof.

GCI/City contend that the Proposed Order erred in concluding that "we do not see AI being able to manage either costs or earnings nearly as effectively in the near term", as not supported by the record. (GCI/City Br. on Exc., pp. 51-52). They are incorrect. Ameritech Illinois' earnings over the initial period of the Plan were significantly impacted by three factors:

[14] Ameritech Illinois notes that GCI/City did not except to the Proposed Order's rejection of earnings sharing. Accordingly, the Company assumes that GCI/City has abandoned this proposal.

(1) the superb economic environment; (2) aggressive cost reductions; and (3) the successful promotion of discretionary services (i.e., vertical features and data services). (Am. Ill. Ex. 8.0, pp. 8-9, 14-18). As Dr. Avera explained, it is unlikely that these conditions are sustainable. With respect to the economy, the last few years have been "as good as it gets". (Am. Ill. Ex. 8.0, p. 13). With the economic growth rate slowing dramatically, Ameritech Illinois' revenues will be impacted generally and discretionary services will be hit the hardest. It will also be difficult to maintain Ameritech Illinois' past record of cost containment: typically, companies make the most obvious cost reductions first and it becomes progressively more difficult to reduce costs further. Growth in discretionary service sales will slow as the market eventually becomes saturated; the growth rates for certain vertical features are already leveling off. (Am. Ill. Ex. 8.0, pp. 19-20, 22-25). Finally, Dr. Avera noted that increasing competition and accelerated technological changes will present a considerable challenge, because of the "size, immobility and embedded technology of [Ameritech Illinois'] network investment". (Am. Ill. Ex. 8.0, p. 25). As Dr. Harris testified, Ameritech Illinois is running a risk just to guarantee productivity performance based on the 1992-99 period, as reflected in the proposed X factor of 3.3%. (Am. Ill. Ex. 4.0, pp. 50-51). Since the Plan's financial performance must be viewed over the long run, not just one year and not even five years, these assessments are highly relevant.

Finally, GCI/City take exception to the statement in the Proposed Order that "rate reinitialization may impact negatively on the growth of competition...." (GCI/City Br. on Exc., pp. 53-54). Contrary to their arguments, it is GCI/City who miss the forest for the trees -- not the Proposed Order. In one breath, GCI/City complain about the fact that residential competition has not developed to the degree they expected and variously blame Ameritech Illinois and/or the Plan. In the next breath, and without any attempt to reconcile their positions, they propose a

$956 million rate reduction which would have a devastating impact on the very competition they are so anxious to promote. The competitive implication of GCI/City's theory of just and reasonable rates is a relevant and appropriate policy consideration.

One of the reasons that competition for residence customers has not developed as quickly as expected is that the same public policies which have kept residential rates affordable have also reduced the profit potential for competitors. As FCC Chairman Powell recently remarked at NARUC:

> "'Retail rates are not an irrelevant part of an economic market' and regulators may have to make a choice between 'sustainable businesses' for new market entrants and low prices for end users." TR Daily, February 28, 2001, pp. 2-3 (administrative notice requested).

Although this Commission made more progress than most towards an economically rational local exchange rate structure during the 1980's, that progress stalled in 1989 with Ameritech Illinois' last major rate rebalancing initiative. (Am. Ill. Ex. 1.1, pp. 45-46). The fact that residential competition in Illinois is not yet robust clearly signals that, even at existing profit margins, the CLECs have more attractive business opportunities. (Am. Ill. Ex. 1.3, pp. 69-70; Am. Ill. Ex. 1.4, pp. 60-61). An almost $1 billion reduction in Ameritech Illinois' local service rates would devastate the economics of this business. Competitors' potential profit margins for a typical residential customer would fall by more than 50%. (Am. Ill. Ex. 1.3, pp. 71-73; Am. Ill. Ex. 1.4, pp. 65-66, Sch. 1). In view of the CLECs' previously tepid response to the residential local exchange business, the rates proposed by GCI will create new, extremely high barriers to entry.

Contrary to GCI's claims, the Proposed Order is not suggesting the ratepayers should subsidize the development of a competitive marketplace. (GCI/City Br. on Exc., p. 54). Rather, the Proposed Order simply recognizes that the Commission has policy alternatives in this proceeding and that these alternatives have consequences. The allegation of "subsidy" rests on GCI/City's view that Ameritech Illinois' rates must be evaluated based on rate case standards. They do not, for all the reasons set forth at length in this proceeding. In any event, a substantial portion of GCI/City's proposed rate reduction results from adjustments that eliminate expenses which Ameritech Illinois actually incurs, impute revenues that the Company does not earn and generally create a fiction that bears no relationship to the real world or the operating conditions of Ameritech Illinois' competitors. GCI/City's willful refusal to address the implications of their proposal for competition does not represent sound public policy.

IV. SERVICE QUALITY - GOING FORWARD

A. LEGAL FRAMEWORK

One of the central legal issues in this proceeding has been the extent to which the Commission may review the Plan based on the likelihood of improving, versus simply maintaining, service quality. GCI/City have now clarified (or perhaps modified) their position on that issue in a manner that essentially eliminates that issue, at least in the abstract. In their Brief on Exceptions, they now concede that "proposals to revise the measures and penalty provisions of the plan are designed to improve Company service quality performance in critical areas only to the extent that performance has been substandard during the life of the Plan." (GCI/City Br. on Exc., p. 55 (emphasis in original)). Thus, with respect to the many GCI/City measures and benchmarks that would require improvements over historical performance levels, GCI/City have accepted the burden of proving that historical performance has been "substandard."

They have not borne that burden. To the contrary, as will be discussed in more detail below, GCI/City have failed to prove that the measures and benchmarks proposed by Ameritech Illinois fall below either historical norms or the Commission's generally applicable service quality rules. In fact, the general approach of Ameritech Illinois and Staff is far more consistent with GCI/City's stated goal than is the approach of GCI/City. Ameritech Illinois and Staff (as well as the Proposed Order) advocate measures and benchmarks based on historical performance levels. However, if historical data are inadequate or do not establish a performance level consistent with the Commission's rules, the standards in the rules would apply. GCI's proposals, on the other hand, go far beyond assuring that service will not be "substandard." By applying internal "stretch" goals or all-time best performance levels, GCI/City would require exceptional, and in some cases impossible, performance levels.

GCI/City should be held to their own rhetoric. Consistent with the approach of Ameritech Illinois, Staff and the Proposed Order, the Plan should be designed to "improve Company service quality performance . . . only to the extent that performance has been substandard during the life of the Plan." (Id.).

B. MEASURES AND BENCHMARKS

1. Exceptions on Issues Raised by Both Staff and GCI/City.

Installation Within Five Business Days (Current). Both Staff and GCI/City take exception to the Proposed Order's findings concerning the definition of Installation within Five Days and the related benchmark. (Staff Br. on Exc., pp. 9-12; GCI/City Br. on Exc., pp. 58-59). Staff and GCI/City argue that this measure should be redefined—although Staff objects to that characterization—to exclude orders limited to vertical services, while maintaining the existing benchmark of 95.44%. These exceptions should be rejected. In fact, as Ameritech Illinois explained in its Brief on Exceptions, the Proposed Order errs in ratcheting the redefined benchmark to 95.44%, given that the existing benchmark is completely meaningless in light of the new definition. (Am. Ill. Br. on Exc., pp. 33-34).

As Mr. Hudzik testified, Ameritech Illinois has always reported installation data in the same way it does today. (Am. Ill. Ex. 12.0, pp. 17-20). Thus, the calculation of the existing benchmark included vertical service orders. Changing the definition of the benchmark without adjusting the benchmark itself would, in effect, arbitrarily raise the standard of service reflected in the plan. Such an increase would be inconsistent with the Commission's determination (and both Staff's and GCI's positions) in the 1994 Order that the goal of the Act is to maintain, not improve, service quality. (Id.; Am. Ill. Ex. 12.1, pp. 23-24). The Proposed Order recognizes that this is true. (HEPO, Section VII, D, 1, Commission Analysis and Conclusions, par. 1).

Staff and GCI/City have argued that no adjustment in the benchmark is needed, because vertical service orders would have been negligible at the time the current Plan was adopted. For example, Mr. McClerren testified that vertical services "did not become a product until the early 1990's . . ." (Staff Ex. 8.0, p. 9). Similarly, Ms. TerKeurst described the number of vertical service orders prior to the adoption of the existing Plan as "negligible" and their impact on performance data as "miniscule." (GCI Ex. 12.0, pp. 26-27). Staff and GCI/City reiterate these arguments in its Brief on Exceptions. (Staff Br. on Exc., pp. 9-12; GCI/City Br. on Exc., pp. 58-59).

These arguments are not supported by the record. Vertical services were well established long before the Plan was adopted. In fact, the vast majority of Ameritech Illinois' current vertical services were introduced between 1974 and 1989. (Tr. 1790-96; Am. Ill. McClerren Cross Ex. 34; Am. Ill. McClerren Cross Ex. 35; Am. Ill. McClerren Cross Ex. 36; Am. Ill. McClerren Cross Ex. 37). It is true that vertical services have generally grown in proportion to total installation orders. However, as the Proposed Order recognizes, the record does not show how fast they have grown, so it is not possible to conclude that such orders would have been "negligible" prior to the adoption of the current Plan. (Tr. 1816-19). In fact, as Ameritech Illinois has pointed out, the new definition of this measure completely invalidates the current benchmark of 95.44%. (Am. Ill. Br. on Exc., pp. 33-34).

Staff (but not GCI/City) now argues that the definition of the benchmark is not being changed. (Staff Br. on Exc., pp. 9-10). That argument cannot possibly be squared with the evidence in the record. As discussed above, it is simply beyond question that the existing benchmark was calculated using data that included vertical service orders. Had those orders been excluded from the original calculation, the benchmark would not be 95.44%. Indeed, for that reason, the old benchmark of 95.44% should not be adopted, even on a phased-in basis. That benchmark simply has no applicability, once it is recognized that the measure itself is being redefined. (Am. Ill. Br. on Exc., pp. 33-34). For the same reason, Staff's proposal to reduce rates by $29.5 million should be rejected, consistent with the findings of the Proposed Order. (Compare Staff Br. on Exc., pp. 10, 12 with HEPO, Section V, H, Commission Analysis and Conclusions).

Percent of Calls Answered (or Abandoned). GCI/City have proposed three separate measures of calls answered (or, conversely calls abandoned), for both residence and business Customer Calling Centers and for Repair Centers. (GCI Ex. 2.0, pp. 43-46). As discussed in Ameritech Illinois' Brief on Exceptions, Staff has changed its position on this issue continuously. (Am. Ill. Br. on Exc., pp. 37-38). Staff initially took a position similar to GCI/City's, proposing two (rather than three) abandoned call measures, for Customer Care Centers (Residence and Business combined) and Repair, respectively. (Staff Ex. 9.0, pp. 24-25). However, in Staff's rebuttal testimony, Ms. Jackson agreed with Ameritech Illinois' position that the Commission should not adopt a measure for the percentage of calls answered or abandoned, and should instead rely entirely on answering time. (Staff Ex. 23, pp. 13-14). Then, in its Reply Brief and its Brief on Exceptions, Staff again reversed its position, while refusing to admit that it had done so. (Staff Reply Br., pp. 60-61; Staff Br. on Exc., p. 23).

The Commission should reject both GCI/City's and Staff's positions. As Mr. Hudzik explained, in Docket 98-0453, the Commission rejected Staff's proposal to include measures for abandoned calls in the Part 730 rules. (Am. Ill. Ex. 12.0, pp. 31, 44). In that proceeding, the Commission concluded, "measurement of abandoned calls is imprecise and the Commission declines to impose a measurement of abandoned calls at this time." Order in Docket 98-0453, adopted February 9, 2000, at p. 8. As Mr. Hudzik explained, "Abandoned calls are at best an indirect measure of answering performance. . . . Why use a less direct and less accurate measure when you can measure answering performance directly?" (Am. Ill. Ex. 12.0, p. 31). In response to Mr. Hudzik's testimony, Ms. Jackson agreed that "Staff is prepared to accept replacement of the abandon rate with an answering time standard." As she explained, "answering time will provide the Staff with the information needed" to assure adequate answering performance. (Staff Ex. 23, pp. 13-14 (emphasis added)).

Ameritech Illinois opposes the adoption of Staff's exception language on this issue, including the language describing Staff's position. Staff suggests that the Commission adopt the following language: "Staff believes that Ameritech does not always have control over or knowledge of why a consumer will hang up before its call is answered, therefore it categorizes the abandon rate as negative reporting. So, Staff proposed to replace the abandon rate with a positive measurement for answering performance, where Ameritech would have total control in the answering of calls." (Staff Ex. 23.0, pp. 14-16; Staff Br. on Exc., p. 23). This language should be rejected for two reasons.

First, it misrepresents Ms. Jackson's testimony. She did not, as Staff now argues, propose "to replace the abandon rate with a positive measure for answering performance . . ." (Id.). Instead, she testified, "Staff is prepared to accept replacement of the abandon rate with an answering time standard." She then repeated her view that "answering time will provide the Staff with the information needed" to assure adequate answering performance. (Staff Ex. 23, pp. 13-14 (emphasis added)). Staff has simply changed its position, and the Commission's order should reflect that.

Second, Staff's proposed language ignores the facts. Calls Abandoned and Calls Answered are simply converse measures; they measure exactly the same thing in different ways. For example, if 10% of calls are abandoned, then 90% are answered. (See GCI Ex. 2.0, p. 38). Changing the way in which the data are reflected will not magically give Ameritech Illinois "total control" over whether customers hang up before Ameritech Illinois can answer their calls.

As a result, the proposals of both GCI/City and Staff should be rejected.

Phase-In of New Measures and Benchmarks. Staff and GCI/City take exception to the Proposed Order's findings regarding the phase-in of new measures and benchmarks. Staff reiterates its position that the phase-in should take place over 18 months, rather than three years. (Staff Br. on Exc., pp. 17-18). GCI/City object to any phase-in at all. (GCI/City Br. on Exc., pp. 67-68). These exceptions should be rejected.

First, Staff appears to overstate the impact of this issue. Ameritech Illinois' intent in developing its position, and Ameritech Illinois' understanding of the Hearing Examiner's Proposed Order, is that the phase-in applies only to new benchmarks. Staff is concerned that this would cover existing Part 730 standards that are simply new to the Plan: Missed Installation Commitments, Average Speed of Answer—Repair, and Average Speed of Answer—Customer

Calling Centers. (Staff Br. on Exc., p. 17). Ameritech Illinois agrees that phasing in existing measures and benchmarks is not necessary, and it has no objection to the inclusion of language that would make that interpretation clear. Ameritech Illinois suggests that the following language be inserted at the end of the existing Commission Analysis and Conclusion:[15]

> "By 'new benchmarks,' the Commission means measures or associated benchmarks that are not currently reflected in the Plan or in the Commission's Part 730 rules. For example, Average Speed of Answer—Repair is not a new benchmark because both the measure and the benchmark reflect existing requirements. Missed Repair Commitments is a new measure because, although the measure appears in the Part 730 rules, we have adopted a more stringent benchmark than the one in the Part 730 rules. Under no circumstances will the phase-in permit performance at levels that do not comply with the Part 730 rules. For Missed Repair Commitments, we have adopted a benchmark of 9.58%, based on the Company's historical performance for the years 1995-99. The initial benchmark for this measure will be 10% (90% of commitments met), not 11.58%, and the Company will be expected to meet the 9.58% benchmark in the second year."

In any event, Staff's proposed 18-month phase-in is too short to accommodate the necessary planning and budgeting. (Am. Ill. Ex. 12.0, pp. 29-30; Am. Ill. Ex. 12.1, pp. 16-17). Changing the benchmarks every six months is also inconsistent with the annual filing cycle for the Plan, which could cause interpretation and administrative problems for the Commission. Therefore, the Commission should adopt Ameritech Illinois' proposal for a three-year phase-in. In light of those facts, the Proposed Order finds, "We believe that a three-year phase-in will better coincide with the Company's planning and budgeting cycle and with the Commission's annual review of the Plan." (HEPO, Section VII, E, Commission Analysis and Conclusions). That finding is correct.

Staff argues that the Commission permitted carriers only "<u>two days</u>" in which to comply

---

[15] The language regarding Missed Repair Commitments assumes that the Commission adopts the Company's exceptions regarding the proper benchmark for that measure. If the Company's exceptions on that issue are not adopted, the final three sentences of the exception language above would not be required because that is the only instance in which the phase-in could potentially permit performance inconsistent with meeting the Part 730 standards.

with the service quality rules adopted in Docket 98-0453. (Staff Br. on Exc., p. 17 (emphasis in original)). That assertion is incorrect. The Commission entered its order in Docket 98-0453 on February 9, 2000, and the rules became effective on October 1, 2000. See Order in Docket 98-0453; 83 Ill. Admin. Code Part 730. Moreover, the new rules had been under discussion in workshops since 1998, and the vast majority of the new rules reflected the agreement of the parties. Order in Docket 98-0453 at pp. 1-4. Thus, the effective lead time for complying with the new rules was more than two years, not two days.

GCI/City argue that the 1994 Order did not provide for a phase-in. (GCI/City Br. on Exc., p. 68). However, in that case, all of the Plan's measures were already reflected in the Commission's service quality rules. Here, many of the measures and benchmarks at issue have never before been regulatory requirements. GCI/City also argue that no phase-in is required because the Proposed Order adopts measures "that the Company already tracks." (Id.). That misses the point. Tracking service quality for internal diagnostic purposes is one thing. Imposing regulatory requirements with major financial penalties for non-compliance is something else entirely. As the Proposed Order properly recognizes, both fairness and good policy dictate that the Commission should allow time for planning, budgeting, hiring, training and all of the other activities that will be necessary to assure compliance with the new requirements.

2. Exceptions of Staff Only.

Missed Repair Commitments. Staff, in its Brief on Exceptions (Staff Br. on Exc., pp. 21-22), suggests that the Commission define Missed Repair Commitments in a manner that would require the Company to complete repairs both within the time committed and within 24 hours. As Ameritech Illinois explained in its Brief on Exceptions, Staff's proposed definition is incorrect and should not be adopted. (Am. Ill. Br. on Exc., p. 36). Staff's definition is inconsistent with the manner in which the underlying data have been reported; thus, adopting Staff's definition would invalidate the parties' proposed benchmarks, including Staff's. Staff's proposed definition is also inconsistent with the intent of this measure, which is to track reliability, not speed. Speed of repair is already addressed by OOS>24. Adopting Staff's definition would, in effect, double count OOS>24.

3. Exceptions of GCI/City Only.

GCI/City take exception to essentially all of the Proposed Order's findings and conclusions regarding service quality measures and benchmarks. Their exceptions raise no new issues, merely recycling the arguments they made previously. (GCI/City Br. on Exc., pp. 54-68). The Proposed Order has properly disposed of those issues, and none of the GCI/City exceptions should be adopted. Ameritech Illinois responded in detail to GCI/City's positions on measures and benchmarks in its Initial Brief and its Reply Brief. (Am. Init. Br., pp. 67-84; Am. Ill. Reply Br., pp. 47-49). At the risk of repetition, Ameritech Illinois will respond again here.

First, as a general matter, the GCI/City proposal would be incredibly onerous. GCI/City's service quality proposal include twenty measures and benchmarks—nearly tripling the number of measures in the existing Plan. This proposal is clearly excessive, particularly considering that, for the most part, the existing Plan has succeeded in maintaining service quality at appropriate levels. (Staff Ex. 23, pp. 28-29; Am. Ill. Ex. 12.0, pp. 37-40).

Moreover, the additional measures and benchmarks proposed by GCI/City are redundant—focussing on service quality parameters (installation, repair, etc.) that are already captured in the measures adopted in the Proposed Order. In addition, GCI/City have redefined many of the measures, rendering available data and benchmarks completely inapplicable to them. Furthermore, the benchmarks for the additional measures proposed by GCI/City are unreasonably stringent, and are generally unrelated to either established performance levels or the Commission's service quality rules. As a result, the additional measures and benchmarks proposed by GCI/City should be rejected. (Am. Ill. Ex. 12.0, pp. 37-46; Am. Ill. Ex. 12.1, pp. 25-31). The Proposed Order is entirely correct in finding that the additional measures are "largely duplicative, confusing and ill-defined for purposes of determining appropriate benchmarks." (HEPO, Section VII, D, Further Conclusions).

Measure-by-measure responses to GCI/City's exceptions follow.

Out of Service Over 24 Hours ("OOS>24"). GCI/City continues to argue that Ameritech Illinois may have overstated "Act of God" (i.e., weather) exclusions by removing trouble reports attributable to unusually severe weather from the numerator in the OOS>24 calculation, but not the denominator. (GCI Br. on Exc., pp. 59-60).

Ameritech Illinois' method of calculating weather exclusions is entirely consistent with past practice, and it is entirely appropriate. As Mr. Hudzik testified, Ameritech Illinois has calculated and reported its OOS>24 data consistently since well before the current Plan was adopted. Moreover, the exclusion of weather-related troubles from the denominator in the equation "would artificially reduce the total number of troubles, essentially implying that [the weather-related troubles] did not exist." That would be inappropriate, as the additional troubles caused by weather remain a part of the workload. (Am. Ill. Ex. 12.1, p. 27). As a result, no change in Ameritech Illinois' reporting for OOS>24 is appropriate at this time. The Proposed Order is entirely correct in approving the continued application of the Company's current methodology until the completion of the pending Part 730 rulemaking proceeding, at which time the Company will comply with the outcome of that proceeding. (HEPO, Section VII, D, 3, Commission Analysis and Conclusions).

Contrary to GCI/City's exceptions, the Hearing Examiners did not "dodge" this question. (GCI/City Br. on Exc., p. 59). To the contrary, the approach of the Proposed Order will assure that Ameritech Illinois' reporting of OOS>24 performance is consistent with that of other companies. Clearly, that is the correct outcome, from a policy perspective. Moreover, GCI/City distort the record when they argue that Ms. TerKeurst "presented uncontroverted testimony that the Company overstates the 'Act of God' or weather-related exceptions" in reporting its OOS>24 performance. That assertion is false and it ignores Mr. Hudzik's testimony to the contrary. (See Am. Ill. Ex. 12.1, p. 27).

Operator Speed of Answer—Toll, Assistance and Information. The Proposed Order adopts Staff's proposal to combine the existing measures and benchmarks for Operator Speed of Answer—Toll and Assistance and Operator Speed of Answer—Information. (HEPO, Section VII, D, 4, Commission Analysis and Conclusion). As Ms. Jackson testified, "the existence of two standards for operator services is unduly burdensome." (Staff Ex. 9.0, p. 26). Ameritech Illinois concurs. (Am. Ill. Ex. 12.0, p. 25). GCI/City opposed Staff's position. GCI/City have included exception language preserving their position on this issue (GCI/City Ex., p. 125), but have not provided any argument in support of their position in their Brief on Exceptions.

Consistent with the Proposed Order, the Commission should adopt Staff's position. Retaining separate benchmarks for the operator assistance measures is not warranted, particularly given that Operator Speed of Answer has not been a problem since the adoption of the Plan. (Staff Ex. 9.0, p. 26). Moreover, there is no evidence that combining the existing measures would result in performance falling below appropriates levels. In fact, Ameritech Illinois has met the benchmarks for both Toll and Assistance and Information calls consistently and by increasing margins over the term of the Plan. (Staff Ex. 8.0, Attach. 8.01). Also, any increases in answer times would be reflected in the overall average, so Ameritech Illinois' incentive and ability to prioritize one set of calls over the other would be very limited.

Repeat Trouble Rate. The parties agree that some form of repeat trouble measure should be included among the service quality measures in the Alternative Regulation Plan. The primary issues are whether to include both installation and repair repeats and, if so, how to reflect those measures in the resulting benchmarks and penalties. There are two forms of "repeat" reports. First, Repair Repeat Troubles are cases of trouble within 30 days after a previous trouble report at the same customer location.[16] (Am. Ill. Ex. 12.0 p. 30). Second, Installation Repeat Reports (or "I Reports") are trouble reports within seven days of installation. (See GCI Ex. 2.0 pp. 52-53).

Staff recommended a single measure and benchmark, which would include both installation repeat and repair repeat reports. (Staff Br., pp. 71, 137). However, as Ameritech Illinois explained in its Reply Brief, those measures are incompatible and cannot be combined in a single measure. (Am. Ill. Reply Br., pp. 48-49). As a result, the Proposed Order adopted a modified version of Staff's proposal under which a single penalty would be divided between separate installation and repair repeat measures. (HEPO, Section VII, D, Commission Analysis and Conclusions). Assuming the Commission adopts the corrected benchmark identified in Ameritech Illinois' exceptions for Installation Repeat Reports, the benchmarks for those measures would be 16.90% for Repair Repeat Reports and 4.41% for Installation Repeat Reports. (See Am. Ill. Br. on Exc., pp. 39-40).

GCI/City take exception to the Hearing Examiners' decision to divide the penalty and the proposed benchmarks. They argue that the Commission should "separate these important

---

[16] Repeat troubles do not necessarily reflect a repetition of the same type of trouble or trouble on the same line. They simply reflect multiple reports at the same location within 30 days.

measures and implement benchmarks of 5% for installation repeats and 10% for repair repeats." According to GCI/City, the Proposed Order would "lock in the Company's poor performance in these areas." (GCI/City Br. on Exc., p. 60).

The GCI/City exceptions should be rejected. In particular, GCI/City's characterization of Ameritech Illinois' performance for repair repeats as "poor" distorts the facts. The FCC's ARMIS reports show that Ameritech Illinois' repeat trouble performance is generally superior to the industry average. At the same time, the GCI/City proposed benchmark of 10% for repair repeats is seldom attained by any company in the country. (Am. Ill. Cross Cox Ex. 7). Ameritech Illinois does not object to GCI/City's proposed benchmark for installation repeats (5%), but believes its proposed benchmark (4.41%) is more consistent with the reasoning of the 1994 Order and the Proposed Order.

<u>Missed Installation Commitments</u>. GCI/City also take exception to the Proposed Order's measure and benchmark for Missed Installation Commitments. GCI/City propose that two, separate measures be adopted: for missed installation "commitments" (which GCI equates with all commitments) and for "appointments" (which GCI equates with field visited commitments). GCI proposes extremely stringent benchmarks of one percent for each. (GCI Br. on Exc., pp. 60-61). That proposal should be rejected.

Initially, GCI/City's proposal is based on a fundamental misunderstanding of the measures it has proposed. Those measures do <u>not</u> track commitments requiring field visits separately from those that do not. In her rebuttal testimony, Ms. TerKeurst contended that what she called "POTS Missed Installation Commitments," reported to the FCC, reflects all commitments, while what she called "POTS Missed Installation Appointments," reported to NARUC, separately reflects field visited commitments. (GCI Ex. 12.0, pp. 43-44). Ms.

TerKeurst is wrong. Both the FCC and NARUC data reflect total installation commitments, including both those that require field visits and those that do not. The two measures differ somewhat in their parameters, but neither of them is limited to commitments requiring field visits. (See Am. Ill. Ex. 12.1, p. 31). The only available data that separately track installation commitments requiring field visits are the data Ameritech Illinois began to provide to Staff in 2000. (Am. Ill. Ex. 3.2, p. 4).

GCI/City's proposed benchmarks for these measures are also inappropriate. They propose a benchmark of one percent for each measure, based on the Company's internal performance target for Missed Installation Commitments (All Commitments). (GCI Ex. 2.0, pp. 58-59; GCI Ex. 12.0, pp. 43-44). These benchmarks should be rejected for several reasons.

First, internal goals do not provide appropriate bases for benchmarks. As Mr. Hudzik testified, "Such goals are used to motivate employees. They are typically chosen as measures of excellence, rather than reasonableness." Those goals do not reflect actual, historical performance. (Am. Ill. Ex. 12.0, pp. 27-28). Adoption of such goals as regulatory requirements would have the perverse effect of encouraging the Company to minimize its performance goals, rather than striving for excellence. (Am. Ill. Ex. 12.1, p. 30). As the Proposed Order finds, "The misuse of such internal targets might well have a chilling effect on a company's business practices and regulators should tread lightly in these areas." (HEPO, Section VII, C, Commission Analysis and Conclusion, par. 5; see also id., Section VII, D, 6, Commission Analysis and Conclusion, par. 2).

Second, to the extent GCI/City would apply her one-percent benchmark to commitments requiring field visits, they have applied the wrong internal target. (Am. Ill. Ex. 12.0, p. 39). The actual internal target for Missed Installation Commitments (Field Visit) was five percent, not one percent. (GCI Ex. 2.2, Resp. to D.R. 4.5).[17]

Third, GCI/City are clearly wrong in arguing that the Proposed Order's benchmark of 10% for this measure would "lock in a deficient level of service quality." (GCI/City Br. on Exc., p. 61). That benchmark is based on the Commission's Part 730 service quality rules which, by definition, identify reasonable levels of service quality performance. 83 Ill. Admin. Code § 730.540(c). In fact, Ms. TerKeurst testified in the original Alternative Regulation Plan proceedings that all of the Plan's benchmarks should be based on the Part 730 rules. (Am. Ill. Cross TerKeurst Ex. 45).

Missed Repair Commitments. GCI/City have not included Missed Repair Commitments in their Brief on Exceptions, but have included exception language to preserve their position on that issue. (GCI/City Exc., pp. 134-35). GCI/City propose a benchmark of one percent for Missed Repair Commitments, based on Ameritech Illinois' internal target for Missed Installation Commitments (All Commitments). (GCI Ex. 2.0, pp. 59-60).

GCI's proposal should be rejected for reasons similar to those discussed for Missed Installation Commitments. First, as explained above, internal targets do not provide appropriate service quality benchmarks under an Alternative Regulation Plan. (Am. Ill. Ex. 12.0, p. 29). Second, GCI/City have again used the wrong target. They have applied a target for all installation commitments (whether or not a field visit is required) to repair commitments requiring field visits. This is a complete mismatch. (Id.). The internal target for Missed Repair Commitments (Field Visit) actually was five percent, not one percent—consistent with the target

[17] That target has since been changed to six percent, as the previous target was too stringent even as a "stretch" goal.

for Missed Installation Commitments (Field Visit). (GCI Ex. 2.2, Resp. to D.R. 4.5).[18] For the reasons stated in Ameritech Illinois' Brief on Exceptions (pp. 34-36), the most appropriate benchmark for this measure is 9.58%, based on historical data for the years 1995-99.

Average Speed of Answer—Repair. Consistent with the approach of the 1994 Order, the Proposed Order adopts a benchmark of 60 seconds average answer time for Average Speed of Answer—Repair. 1994 Order at p. 58. The standard is based on the Commission's Part 730 service quality rules. (HEPO, Section VII, D, 8, Commission Analysis and Conclusion). GCI/City take exception to that finding, proposing a standard of 80% answered within 20 seconds. The proposal is based on Ameritech Illinois' internal performance target. (GCI/City Br. on Exc., pp. 61-62).

The Commission should follow the 1994 Order and adopt the 60-second benchmark that appears in the Part 730 rules. 1994 Order at p. 58. Again, Ameritech Illinois notes that Ms. TerKeurst previously testified that all of the benchmarks in the Plan should be based on the Part 730 rules. (Am. Ill. Cross TerKeurst Ex. 45). Moreover, GCI/City's proposed answering time standard lacks either a historical performance record or a Commission rule to support it. As a result, it cannot be said to "maintain" any recognized level of performance, and it is therefore inconsistent with the Act and the 1994 Order. (Id., p. 17). In addition, while GCI/City argue that that benchmarks should be based on pre-Plan data, those data do not support their proposed benchmarks for answering performance. (GCI/City Br. on Exc., p. 58). In fact, answering times prior to the adoption of the Plan did not meet GCI/City's proposed benchmarks. (Compare GCI Ex. 12.0, pp. 32-34 with Am. Ill. Ex. 3.4, p. 18 & Sch. 3.44). GCI/City have conveniently ignored that evidence, as well as the inconsistencies in their own position. Finally, as discussed

[18] This internal target has also subsequently been changed to six percent.

elsewhere, internal performance targets are not appropriate bases for service quality benchmarks.

Average Speed of Answer—Customer Calling Centers. Staff proposed, and Ameritech Illinois agreed, that a single measure should be adopted to reflect both residence and business calling centers. (Staff Ex. 23, p. 29; Am. Ill. Ex. 12.1, p. 28). The Proposed Order adopts that position. (HEPO, Section VII, D, 9, Commission Analysis and Conclusions). GCI/City, however, propose that separate answering time measures should be adopted for residential and business Customer Calling Centers. (GCI Br. on Exc., pp. 62-63). [1]

GCI/City's proposal should be rejected, for several reasons. Initially, GCI/City's proposal is inconsistent with the manner in which business office answering time is defined in Part 730. Contrary to GCI/City's proposal, the Commission's rules provide a single, combined measure and benchmark for both residence and business Customer Calling Centers. 83 Ill. Admin. Code § 730.510(c). As a matter of policy, the service quality provisions in the Plan should be consistent with the Commission's rules. In addition, a single measure is fully adequate to track business office answering time. Adopting two measures would over-emphasize answering time in the context of the overall service quality component of the Plan. (Am. Ill. Ex. 12.1, p. 28).

The Proposed Order adopts a benchmark of 60 seconds average answering time, once again based on the Commission's Part 730 rules. Once again, GCI/City take exception, proposing a standard of 80% of calls answered within 20 seconds. (GCI/City Br. on Exc., pp. 62-63). That benchmark should be rejected for the same reasons discussed with regard to Average Speed of Answer—Repair, above.

Mean Installation and Repair Interval. GCI/City take exception to the Proposed Order's rejection of their proposed measures and benchmarks for Mean Installation Interval and Mean

Repair Interval. According to GCI/City, the "HEPO fails to adopt, let alone address" these measures, which they characterize as "critical to diminish any incentive the Company might have to stop attempting to meet the repair and installation benchmarks because of a recognition that performance has been inadequate to satisfy the annual benchmarks." (GCI/City Br. on Exc., pp. 65-67). Their position should be rejected, although Ameritech Illinois would not object to the addition of language providing more specific reasons for doing so.

GCI/City propose that the Commission adopt a measure for what they call "POTS Mean Installation Interval", with a proposed benchmark of four business days. The recommendation is based on Ms. TerKeurst's speculation that, unless the Commission adopts this additional standard, installations not completed within five business days would be moved "to the bottom of the work queue." (GCI Ex. 2.0, pp. 35-36). There is simply no factual basis for the GCI/City position. As Mr. Hudzik testified, Ameritech Illinois has never engaged in the practice that Ms. TerKeurst alleges, and the record contains no evidence to the contrary. (Am. Ill. Ex. 12.0, p. 44). This is particularly significant, given that installation performance will already be subject to two measures under the Plan—Installation within Five Days and Missed Installation Commitments. A third installation measure would be excessive.

Moreover, Ms. TerKeurst's proposed benchmark is not based on historical performance, Commission rules or any other known standard. Ms. TerKeurst has simply invented it. (Id., p. 40). As a result, the benchmark could not plausibly be said to "maintain" any known level of performance.

GCI/City also propose that the Commission adopt a standard for "POTS Mean Time to Repair". (GCI/City Br. on Exc., pp. 65-67). Their rationale is essentially the same as for Mean Installation Interval. Ms. TerKeurst testified that this measure, in addition to OOS>24, will "provide complementary information and discourage Ameritech Illinois from neglecting out of service problems older than 24 hours." (GCI Ex. 12.0, pp. 36-37).

This GCI/City proposal should also be rejected. The measure is redundant, and there is not a shred of evidence that the Company has ever engaged in the practice Ms. TerKeurst alleges. In fact, Mr. Hudzik testified that it does not. (Am. Ill. Ex. 12.0, p. 45; Am. Ill. Ex. 12.1, p. 29).

GCI/City have proposed as the benchmark for this measure an internal "stretch" goal of 21 hours. Such a benchmark would be inappropriate for the reasons explained above regarding the use of internal targets as benchmarks. Moreover, what Ms. TerKeurst calls "POTS" Mean Time to Repair would apparently be "limited to POTS" service (see GCI Ex. 12.0, p. 37 (discussing "POTS" installation)). This is not the same measure as the one tracked by the Company's Mean Time to Repair data, which is not limited to "POTS" service. As a result, the proposed benchmark would be inappropriate, even if internal targets were otherwise an appropriate basis for determining benchmarks.

Therefore, Ameritech Illinois recommends that the Commission add the following language at the end of the "Further Conclusions" section of the Proposed Orders discussion of measures and benchmarks (HEPO, Section VII, D, Further Conclusions):

> "Specifically, we reject the suggestion of GCI/City that we adopt a measure and benchmark for POTS Mean Installation Interval. We are already adopting two measures of installation performance (Installation within Five Days and Missed Installation Commitments). Although installation is an important aspect of service quality, it does not merit yet a third measure and benchmark, particularly given the complete lack of evidence that Ameritech Illinois has ever engaged in the type of conduct that GCI/City allege. In addition, we are unable to identify any factual basis upon which GCI/City based their proposed benchmark for this measure. We reject GCI/City's proposed measure and benchmark for POTS Mean Repair Interval for similar reasons. We are already adopting two measures of repair performance (OOS>24 and Missed Repair Commitments). We do not see a need for a third measure, absent evidence that Ameritech Illinois is, in fact, neglecting repair cases after the initial 24-hour period has

run. Moreover, as we have discussed previously, internal targets do not provide appropriate bases for regulatory benchmarks."

C. INCENTIVE STRUCTURE

All of the parties have changed their positions regarding the Plan's service quality incentive structure significantly in response to the Proposed Order. The parties no longer advocate their original proposals. Moreover, in their Exceptions, neither Staff nor GCI/City object to the Proposed Order's incentive structure, as a general matter. For example, neither takes exception to the proposed base penalties or to the general structure of the incentives adopted by the Hearing Examiners. Nevertheless, both parties argue that certain aspects of the Proposed Order fail to impose adequate service quality incentives.

The exceptions of Staff and GCI/City should be rejected. As Ameritech Illinois has argued, the Proposed Order's incentive structure is far too severe, not too lenient. The exceptions of both Staff and GCI/City rely on the same argument: that the existing Plan has generally failed to maintain service quality, as required by the Act. That premise is absolutely wrong, and so are the arguments that rely upon it. (See Am. Ill. Br. on Exc., pp. 27-31).

1. Exceptions on Issues Raised by Both Staff and GCI/City.

General Exceptions to the Proposed Order's Incentive Structure. As noted above, the exceptions of both Staff and GCI/City rely on the premise that the Plan has generally failed to maintain service quality. The record simply does not support that assertion, and it therefore does not support those exceptions.

Staff argues, "It cannot be disputed, based upon the record in this proceeding, that penalties and rate reductions imposed in prior proceedings were not sufficient to induce or compel Ameritech to meet its service quality obligations." (Staff Br. on Exc., p. 12). GCI/City have taken a similar position. (GCI/City Br. on Exc., pp. 55-57).

These assertions will no doubt come as news to Staff's service quality witness, Ms. Jackson. Regarding the existing service quality measures, except for OOS>24 and Installation within Five Days, Ms. Jackson testified, "the $4 million [now approximately $2.6 million] rate reduction for each of these standards was enough incentive for the company to meet the standards." She also recommended the same penalty for Staff's proposed new measures (assuming service quality remained within the price cap index), testifying that there is no reason to believe that greater penalties would be necessary to assure compliance with any of the new benchmarks. (Staff Ex. 9.0, p. 45 (emphasis added)).

Ameritech Illinois' witness, Mr. Hudzik, agreed. As he testified, there is no evidence that greater penalties are either necessary or appropriate, given that Ameritech Illinois has not missed any of those benchmarks, with the exception of OOS>24. (Am. Ill. Ex. 12.1, pp. 33-34). Apparently, Staff and GCI/City have either forgotten or ignored both Mr. Hudzik's testimony and Ms. Jackson's, as well as the clear empirical evidence upon which their conclusions were based. The objective data in the record demonstrate that service quality on the whole not only has been maintained, but in fact has clearly improved, under the Plan.

Ameritech Illinois' overall quality of service during the first five-year term of the Plan was excellent. (Am. Ill. Ex. 1.1, pp. 37-39, 84-85). In fact, virtually all measures of service quality improved significantly under the Plan—the only significant exception being the measure for out of service over 24 hours ("OOS>24"). For example, during the initial term of the Plan, Ameritech Illinois' performance improved for seven of the eight current benchmarks—in many cases very significantly. (Am. Ill. Ex. 12.0, pp. 14-22; Am. Ill. Ex. 12.1, pp. 6-8). Even if one judges service quality on the bases suggested by Staff's or GCI/City's witnesses, performance has clearly improved. In fact, the only existing measures that are even subject to debate are

OOS>24 and Installation within Five Days. Otherwise, there is literally no evidence that Ameritech Illinois has failed to maintain service quality.[19]

For example, Mr. McClerren focused on so-called monthly "misses" in his direct testimony. (Staff Ex. 8.0, p. 6). However, aside from OOS>24, monthly data confirm that Ameritech Illinois' performance has improved steadily under the Plan. For the other seven existing measures, Ameritech Illinois' performance exceeded the benchmarks for 399 of 420 monthly data points (95%). Moreover, the number of monthly "misses" fell steadily between 1994 (17 misses) and 1999 (four misses). Considering that those benchmarks were based on annual, not monthly, performance during 1990-91, that is a remarkable record. (Am. Ill. Ex. 12.1, pp. 15-17).

In his rebuttal testimony, Mr. McClerren suggested comparing the average level of performance prior to the adoption of the Plan (using data for the periods 1990-94 and 1990-91) to performance since the Plan was adopted (1995-2000). Once again, those comparisons confirm that performance has improved substantially for all service quality measures, with the single exception of OOS>24. (Am. Ill. Ex. 12.2, pp. 6-8). In fact, many of the most important measures of service quality improved by large margins. For example, Trouble Reports per 100 Access Lines, the best overall measure of network performance, improved by more than 30% from 1990-94 to 1995-2000. The other measures improved over that period by margins ranging from roughly 20% to 100%. Thus, based on Staff's own approach, most measures of service quality have improved very substantially. (Am. Ill. Ex. 12.1, pp. 6-8).

[19] GCI/City have also argued that business and repair office answering times declined under the Plan, but they never identified any empirical evidence to show that this was true. In fact, answering times prior to the adoption of the Plan were generally comparable to those after its adoption. (Compare GCI Ex. 12.0, pp. 32-34 with Am. Ill. Ex. 3.4, p. 18 & Sch. 3.44). GCI/City's arguments on this issue hardly constitute evidence, particularly considering that the empirical evidence in the record directly contradicts their position.

GCI/City's service quality witness, Ms. TerKeurst, argued that performance for measures that are not included in the Plan should also be considered. (GCI Ex. 12.0, pp. 3-6). However, that analysis (which Ms. TerKeurst failed to perform herself) again shows that service quality has improved. Data since the adoption of the Plan are either consistent with or better than pre-Plan data for all such measures for which data are available: Business Office Answering Time, Repair Office Answering Time, Repeat Trouble Rate (Installation), Repeat Trouble Rate (Repair), and Missed Repair Appointments. (Compare Am. Ill. Ex. 3.4, pp. 17-19 & Sch. 3.44 with GCI Ex. 2.1). Thus, service quality has also improved based on the approach suggested by GCI/City.

Even regarding OOS>24, the Company's conduct since 1999 demonstrates that the existing penalties (including the $30 million merger penalty) are adequate to maintain reasonable performance. In 1999, the Commission imposed a $30 million dollar penalty if Ameritech Illinois fails to attain 5% OOS>24. As shown by the very significant improvement in 00S>24 performance since that penalty was adopted, this incentive has been adequate to incent the Company to meet the benchmark. (Am. Ill. Ex. 12.1, p. 35). Moreover, the problems experienced in the latter half of 2000 have been addressed by force additions in the Network organization. These force additions demonstrate a strong commitment to deliver the required level of service. (Id., pp. 34-35).

Nor is there any basis to increase penalties for Installation within Five Days should also be rejected. Despite Staff's (and GCI/City's) concerns about the manner in which the data have been calculated, the fact remains that the Company reported this measure in the same way as it always has, consistent with the manner used when the original benchmark was developed. The Company has met this measure on a consistent basis. Ameritech Illinois does not object to redefining this benchmark in the manner suggested in the Proposed Order. However, to penalize the Company for Staff's and GCI/City's concerns over the calculation methodology, when it has never missed the current benchmark, would clearly be unfair. (Am. Ill. Ex. 12.1, p. 35).

Thus, as Ameritech Illinois argued in its Brief on Exceptions, the penalties in the Proposed Order are far too severe, not too lenient. (Am. Ill. Br. on Exc., pp. 27-31). As a result, Staff's and GCI/City's arguments to increase service quality incentives should be rejected.

Customer-Specific Remedies. Both GCI/City and Staff take exception to certain aspects of the Proposed Order's customer-specific remedies. GCI/City argue that that a $50 payment should be adopted for failure to keep installation or repair appointments and that a cellular loaner program should be established. (GCI/City Br. on Exc., pp. 72-73). Staff argues that the proposed penalties for installation and repair delays should be increased substantially, and that a cellular loaner program be adopted. (Staff Br. on Exc., pp. 13-16, 37-38). These exceptions should be rejected, or at minimum, substantially modified.

First, Ameritech Illinois agrees with the Proposed Order's observation that "It is one thing to propose shat appears to be an attractive option. It is an entirely different thing to substantiate the inner workings, the costs, efficiency, potential abuse and the legal pitfalls of such a program." (HEPO, Section VII, F, Commission Analysis and Conclusion, par. 4). Neither GCI/City nor Staff make any attempt at all to address that observation, or to suggest any means of addressing the "inner workings" of their proposals. Staff argues that the Proposed Order is somehow inconsistent with the service quality provisions of H.B. 2900. (Staff Br. on Exc., pp. 37-38). Staff has missed a key difference between its proposal and H.B. 2900. The General Assembly recognized that implementation of the service quality remedies it created will be complex and will take time. Therefore, the General Assembly did not create remedies that would be effective immediately. Instead, it required the Commission to complete a rulemaking docket, which it provided a year to complete. H.B. 2900 § 13-712(c).

Contrary to Staff's view, H.B. 2900 underscores the correctness of the Proposed Order's conclusions. Implementation of an "alternative service" option in concert with the rest of the industry and upon completion of the Commission's rulemaking will permit smoother and more consistent implementation by Ameritech Illinois. In addition, the Commission can avoid needless inconsistencies between the Plan and the industry-wide rules. As a result, both Staff's and GCI/City's proposals to require an immediate "alternative service" remedy should be rejected. To assure consistency across the industry and to avoid conflicts between H.B. 2900 and the Plan, that remedy should be implemented through H.B. 2900 and the related rulemaking process.

GCI/City's proposal to make alternative service available to other carriers should also be rejected. (See GCI/City Br. on Exc., p. 72). Wireless services are highly competitive and are readily available to other carriers from many vendors. In fact, Ameritech Illinois itself does not provide wireless service. It will need to purchase that service, just like any other carrier. Thus, it is far from clear how or why Ameritech Illinois could be required to provide that service to other carriers. Finally, Ameritech Illinois notes that the General Assembly included no such requirement in H.B. 2900; thus, the GCI/City proposal would be inconsistent with the Act. H.B. 2900, § 13-712(e).

Ameritech Illinois also notes that, while Staff wraps itself in H.B. 2900 when it addresses alternative service, Staff advocates customer credits for installation and repair delays that are substantially in excess of those required under H.B. 2900 and also would be structured in a fundamentally different manner. (Compare Staff Br. on Exc., pp. 16-17 with H.B. 2900, § 13-

712(e)). Staff's proposed customer compensation scheme should be rejected. Instead, as Ameritech Illinois explained in its Brief on Exceptions (pp. 31-33), the customer-specific remedies identified in the Proposed Order should be adopted and retained until the Commission completes its rulemaking pursuant to Section 13-712 of H.B. 2900. At that time, all service quality measures for which customer compensation is required by the Commission's rules should be removed from the Plan and addressed only under the rules. At minimum, even if those measures are not eliminated from the Plan, customer compensation under the Plan should be consistent with compensation under H.B. 2900. The approach suggested by Staff is both discriminatory and confusing.

<u>Deduction of Customer Compensation and Administrative Expenses</u>. Both Staff and GCI/City object to the Proposed Order's conclusion that customer compensation and administrative expenses should be deducted from any annual penalties paid under the Plan. (Staff Br. on Exc., pp. 13-14; GCI/City Br. on Exc., pp. 69-71). These exceptions should be rejected.

The Proposed Order properly finds that the Commission's goals in adopting service quality incentives should be to "promote efficient investment in compliance" and to "avoid a double penalty." (HEPO, Section VII, F, Commission Analysis and Conclusion, par. 2, 17). Those goals are consistent with generally applicable legal principals governing remedies. Those principals dictate that customers be compensated once, not twice. To the extent customers have been compensated (either through customer-specific remedies or through generalized penalties), any additional compensation is, by definition, too much. Ultimately, such over-regulation reduces overall social welfare, contrary to the interests of both consumers and the Company.

See, e.g., Patton v. Mid-Continent Systems, Inc., 841 F.2d 742, 750-51 (7^{th} Cir. 1988); Allahpattah Services, Inc. v. Exxon Corp., 61 F. Supp. 2d 1326, 1329-30 (S.D. Fla. 1999).[20]

Moreover, the exceptions of Staff and GCI/City are inconsistent with established Commission practice. The Commission has always permitted utilities to deduct administrative expenses from refunds owed to customers. That practice has been noted with approval in appellate decisions reviewing the Commission's refund orders, recognizing that such expenses. For example, in reviewing the Commission's order governing refunds by Commonwealth Edison Company, the Supreme Court of Illinois observed that administrative expenses "would have to be taken out of the refund amount." People ex rel. Hartigan v. Commerce Commission, 148 Ill. 2d 348, 414 (1992). Neither Staff nor GCI/City have provided any basis upon which the Commission should, or even could, abandon that practice here.

2. Exceptions of Staff Only.

Annual Base Penalty Increases. Staff argues that the $2 million annual increases in the Proposed Order's base penalties should be increased to $4 million, but that the increases should be imposed only in years in which a benchmark has been missed. As Ameritech Illinois explained above and in its Brief on Exceptions, the incentives in the Proposed Order are far too severe, and no increases in base penalties are warranted—annual or otherwise. (Am. Ill. Br. on Exc., pp 27-31). However, if annual increases to base penalties are adopted, Ameritech Illinois agrees with Staff's position that such increases should be imposed only in years in which a benchmark has been missed.

As Staff appears to recognize, there would be no reason to increase the annual base penalties if Ameritech Illinois has met the Commission's benchmarks. Missing a service quality

---

[20] Perhaps the most obvious recent example is the California energy crisis, in which the State of California essentially regulated its way into a complete breakdown of the electric power market.

benchmark in the year 2006 will not affect consumers differently from missing a benchmark in the year 2002. Therefore, to the extent that Staff's approach would limit increases to years in which a benchmark had been missed, that approach would be good policy. Under Staff's suggested approach, increases in base penalties would act as an additional incentive for the Company to meet the benchmarks, rather than simply increasing from year to year regardless of performance. Therefore, if Ameritech Illinois' exceptions regarding overall penalty levels are rejected, in the alternative, annual increases in the initial level of base penalties should be imposed only in years in which the Company has missed one or more of the Commission's benchmarks, as suggested by Staff. (See Staff Br. on Exc., pp. 14-15).

Severity Escalation Factors. The Proposed Order would impose additional $2 million and $4 million service quality penalties if Ameritech Illinois misses service quality benchmarks by more than five percent or ten percent, respectively. Staff suggests exception language interpreting the Proposed Order to impose a "percentage of a percentage" approach. For example, for OOS>24, Staff would impose an additional $2 million penalty if performance were worse than 5.25% and an additional $4 million penalty if performance were worse than 5.50%. (See Staff Br. on Exc., p. 15). Staff did not provide any argument (or evidence) supporting that interpretation, and it should be rejected.

There is literally no evidence supporting Staff's position in its exception. In fact, both Ms. Jackson and Ms. TerKeurst proposed "severity factors" that took a "percentage of the whole" approach. Again using OOS>24 as an example, both Ms. Jackson and Ms. TerKeurst testified that additional severity factors should apply only if Ameritech Illinois missed the five-percent benchmark by five or ten percent of the total—not five or ten percent of five percent. Thus, for example, an additional penalty would apply for performance worse than ten percent out of service over 24 hours and a further penalty would apply for performance worse than fifteen percent out of service over 24 hours. (GCI/City Ex. 2.0, pp. 61-62; Staff Ex. 9.0, p. 47). None of the witnesses in this proceeding supported Staff's "percentage of a percentage" approach.

In addition to lacking any support in the record, Staff's interpretation makes no sense. The "percentage of a percentage" approach would impose millions of dollars in additional penalties for truly tiny changes in performance. The example used by Staff in its Brief on Exceptions provides a good illustration. The benchmark for Trouble Reports per 100 Access Lines is 2.66. Staff would impose an additional penalty of $4 million for performance exceeding 2.79 Trouble Reports per 100 Access Lines. This is a margin of only 0.13% of total access lines. That proposal is irrational, which no doubt is why neither Ms. Jackson nor Ms. TerKeurst supported it.

Ameritech Illinois notes that answering times are measured in seconds, rather than percentages, and therefore would need separate severity factors. Although Ameritech Illinois generally opposes the severity escalation factors, Ameritech Illinois suggests that such factors should be reasonably proportionate across measures and benchmarks. As a result, if severity escalation factors are adopted, Ameritech Illinois suggests that appropriate factors for answering time would be an additional $2 million for performance worse than 120 seconds average answering time and $4 million for performance worse than 180 seconds. This would approximate the relationship between severity escalation factors proposed by Ms. Jackson and Ms. TerKeurst for other measures.[21]

Staff has also suggested that the severity factors in the Proposed Order be doubled, from $2 million or $4 million, to $4 million or $8 million. Staff has provided neither argument nor evidence to support its proposal. (Staff Br. on Exc., p. 15). Similarly, Staff has failed to provide either argument or evidence supporting its proposed language imposing cumulative annual increases of $8 million over the proposed base penalty for missing the benchmark for OOS>24. (Id., pp. 15-16). These proposals should be rejected. In this regard, Ameritech Illinois notes that GCI/City, who represent consumers in this proceeding, have not taken exception to the severity factors adopted by the Hearing Examiners. This strongly suggests that the severity factors in the Proposed Order are, at the very least, sufficient. Indeed, as Ameritech Illinois has argued, the penalties are actually far too severe.

D. OTHER ISSUES

Wholesale Service Quality. Various parties contend that the Proposed Order should order that the wholesale service quality measure, benchmarks and penalties associated with Merger Condition 30 should be adopted in this proceeding and extended as a part of the Alternative Regulation Plan. The Hearing Examiners properly rejected that suggestion in the Proposed Order. They found:

> We see no good reason to further expand the scope of this docket. The Commission will adopt McLeod's proposal that we address issues concerning wholesale service quality in Docket 01-0120. Issues concerning wholesale service quality can also be addressed in a wide variety of other proceedings, as Ameritech Illinois observed. The record in this proceeding is simply inadequate to address, in any meaningful way, the issues of wholesale service quality. (HEPO, Section VII, G, 3, Commission Analysis and Conclusion).

That conclusion is clearly correct. However, there is an additional reason not to address wholesale service quality here. Proceedings in Docket 01-0120 have not yet been completed. Moreover, as the Hearing Examiners note, wholesale service quality is subject to a variety of

---

[21] Both Ms. Jackson and Ms. TerKeurst proposed that an additional penalty apply for each additional five-percent increase in the OOS>24 rate, for which the benchmark is five percent. (GCI/City Ex. 2.0, pp. 61-62; Staff Ex. 9.0, p. 47).

other proceedings. As a result, wholesale service quality measures, benchmarks and penalties remain open issues. In effect, the parties taking exception to the finding above are asking the Commission to incorporate into the Plan a set of wholesale service quality provisions that do not exist yet, and to commit to maintain those provisions for the term of the Plan. There is no good policy reason to make that commitment here.

V. RATE REBALANCING

GCI/City suggest that the Proposed Order be modified to "expand" upon the "rationale" for rejecting Ameritech Illinois' rate rebalancing proposal. (GCI/City Exc., p. 29). The arguments made by GCI/City in opposition to the rate rebalancing proposal are fully addressed in the Company's Initial and Reply Briefs. That discussion will not be repeated here. As the Company explained in its Brief on Exceptions, Ameritech Illinois is withdrawing the rate rebalancing proposal at this time in order to assess the potential impact of H.B. 2900 on the Company's rate structure. Accordingly, there is no immediate need for the Commission to resolve the contested cost of service and policy issues alluded to by GCI/City.

Ameritech Illinois is, however, compelled to respond to a gross mischaracterization of the evidence regarding cost of service which is contained in GCI/City's Brief on Exceptions. GCI/City claim that GCI witness Dunkel "was the only witness to perform an extensive analysis of the Company's costs." (GCI/City Br. on Exc., p. 28). This claim is patently false. William C. Palmer, a principal of the economics and finance consulting firm of LECG, presented extensive evidence analyzing Ameritech Illinois' costs and supporting the cost of service studies relied on by the Company as support for its rate rebalancing proposal. (Am. Ill. Ex. 10.0; Am.

Ill. Ex. 10.1; Am. Ill. Ex. 10.2; Am. Ill. Ex. 10.3).[22] The evidence presented by Mr. Palmer demonstrates that, contrary to GCI/City's assertions, residence access lines are currently priced well below long run service incremental cost ("LRSIC") in access areas B and C. (Am. Ill. Ex. 9.4P, Corrected Sch. 2). Although current rates cover LRSIC in access area A, when shared costs[23] and non-recurring costs[24] are included, the rate is below cost even in access area A. (Id.).

Unlike Mr. Palmer, Mr. Dunkel did not perform any cost of service studies for this proceeding. Instead, Mr. Dunkel proposed adjustments to the results of the Company's cost studies to correct what Mr. Dunkel alleged to be "errors" made in the calculation of certain of the inputs to the Company's cost models. With one exception, however, Mr. Dunkel's allegations and proposed adjustments were without merit for reasons fully discussed by Mr. Palmer in his rebuttal and surrebuttal testimony. (Am. Ill. Ex. 10.1, pp. 2-46; Am. Ex. Ill. 10.3, pp. 1-24).[25] The evidence does not, therefore, support GCI/City's assertion that the "NAL rate can be reduced by $1.30 and still exceed LRSIC." (GCI/City Br. on Exc., p. 28).

GCI/City include in their Exceptions suggested order language addressing cost of service issues as they relate to the rate rebalancing proposal. (GCI/City Br. on Exc., pp. 60-65). This language suffers from the same defects as the Proposed Order's language in that it (i)

---

[22] Mr. Palmer, who has over 20 years of experience in performing cost of service studies, uniquely qualified to testify on the cost of service issues in this case. (Am. Ill. Ex. 10.0, Sch. 1). Prior to joining LECG in 1998, Mr. Palmer was Ameritech's Director of Economic Analysis, a position in which he was responsible for developing the methodological framework for the cost studies of Ameritech and all of its operating telecommunications subsidiaries, including Ameritech Illinois. (Id., pp. 1-2). Mr. Palmer has presented testimony on cost of service matters in numerous regulatory proceedings in Illinois and other states. (Id.).

[23] Shared costs are LRSICs incurred to provide a category or group of services. A ratable portion of these costs needs to be allocated to each service that shares the facility or function.

[24] Non-recurring costs are the incremental service ordering and installation costs incurred to provision access lines. These costs slightly exceed current service ordering and installation (non-recurring) charges. The shortfall needs to be recovered in the recurring rates for access lines.

[25] The one exception was Mr. Dunkel's correct assertion that the Company inadvertently added residential and business line field installation costs when those costs should have been weighted. A correction of that error (which does not affect the conclusion that network access lines are currently priced below cost) is reflected in the revised LRSICs set forth in Sch. 9 (Rev.) of Ameritech Illinois Exhibit 10.1 and Sch. 4 of Ameritech Illinois Exhibit 10.3.

mischaracterizes Mr. Dunkel's arguments regarding the Company's LRSIC studies as criticisms of a particular model (LFAM) used to develop those studies when, in fact, Mr. Dunkel's arguments had nothing to do with LFAM; and (ii) omits any discussion of the extensive evidence presented by the Company refuting each of Mr. Dunkel's assertions.

For the reasons discussed above and in the Company's Brief on Exceptions, GCI/City's exceptions regarding cost of service and rate rebalancing issues should be rejected. (Am. Ill. Br. on Exc., pp. 41-65). Instead, the Proposed Order should be modified, in the manner proposed in the Company's Exceptions, to (i) correct the Proposed Order's summary of GCI's arguments; (ii) include a summary of Ameritech Illinois' responses to Staff's and GCI's arguments regarding the LFAM and the Company's LRSIC studies; and (iii) approve the LFAM and the Company's LRSIC studies. (Am. Ill. Exc., pp. 10-16). At a minimum, the Commission should eliminate the Proposed Order's statements criticizing the LFAM and LRSIC studies because those statements are unsupported by the evidence and unnecessary in light of the Company's decision to withdraw its rate rebalancing proposal.

VI. OTHER ISSUES

In the section of their Brief on Exceptions entitled "Other Issues," GCI/City criticize the Proposed Order for not including a "thorough discussion" of the Company's "revenue requirements" and related evidence concerning cost of capital, depreciation, and other "accounting issues." (GCI/City Br. On Exc., pp. 74-75). GCI/City also present a brief overview of their positions regarding (i) the Company's "revenue requirement" and two related issues (depreciation and cost of capital) and (ii) their proposed rate design for implementing "rate reinitialization." (GCI/City Exc., pp. 75-83). GCI/City further indicate that their Exceptions incorporate a more detailed discussion of GCI/City's arguments on "revenue requirements" issues (including cost of capital and depreciation expense) and rate design.

For all the reasons previously discussed, the Proposed Order was correct in concluding that the reasonableness of rates subject to price regulation should not be determined on the basis of a traditional "revenue requirement" analysis of the type presented by GCI/City and, therefore, that GCI/City's rate reinitialization proposal should be rejected. Accordingly, the Proposed Order's omission of a revenue requirements analysis was entirely appropriate. For the same reasons, there was no need for the Proposed Order to address GCI/City's rate design proposals. GCI/City's arguments and exceptions related to earnings, cost of capital, depreciation and other accounting issues and rate design should, therefore, be rejected.

Because there is no need for the Commission to amend the Proposed Order to include a detailed discussion of revenue requirements issues, Ameritech Illinois does not intend to respond to GCI/City's contentions regarding those issues in this Reply Brief on Exceptions. The Commission should be aware, however, that GCI/City's revenue requirements analysis and rate design proposals were highly contested. For the Commission's convenience, Ameritech Illinois has included in Appendix B to this Reply Brief on Exceptions a summary of its arguments regarding the issues addressed by GCI/City in their Brief on Exceptions and Exceptions. For the reasons discussed in Appendix B, GCI/City's revenue requirements analysis is fundamentally flawed. Among other problems, GCI/City propose to arbitrarily adjust the Company's normal operating results for 1999 by (i) "disallowing" reasonable expenses incurred by the Company to provide service and (ii) "imputing" to the Company revenues which it did not (and will not) receive. The effect of GCI's approach is to overstate the Company's earnings by hundreds of millions of dollars.

Thus, even if the Commission were to determine that an analysis of Ameritech Illinois' earnings and revenue requirements is necessary and appropriate (and it is not), it would not be appropriate to adopt GCI/City's proposed exception language. Rather, it would be necessary for the Commission, pursuant to 220 ILCS 5/10-111, to direct the Hearing Examiners to prepare a revised Proposed Order setting forth findings and conclusions on the revenue requirements and rate design issues and provide the parties with an opportunity to respond to that revised Proposed Order.

CONCLUSION

In view of the foregoing, the Commission should accept the modifications to the Proposed Order recommended by Ameritech Illinois and reject the changes proposed by the other parties.

Respectfully submitted,

ILLINOIS BELL TELEPHONE COMPANY

by ____________________________
One of its Attorneys

Louise A. Sunderland
Karl B. Anderson
Mark A. Kerber
Attorneys for Ameritech Illinois
225 West Randolph Street
Floor 25D
Chicago, IL 60606
(312) 727-6705
(312) 727-2928
(312) 727-7140

Edward A. Butts
1800 West Hawthorne Lane, Room 102
West Chicago, Illinois 60185
(630) 562-1515

CERTIFICATE OF SERVICE

I, Louise A. Sunderland, an attorney, hereby certify that copies of the foregoing Reply Brief on Exceptions of Ameritech Illinois were served upon the attached service list via Federal Express on June 25, 2001.

____
Louise A. Sunderland

SERVICE LIST FOR

I.C.C. Docket No. 98-0252/98-0355 (Consol.)

Jack A.Pace
City of Chicago
Public Utilities Unit
30 North LaSalle St., St. 900
Chicago, IL 60602-2580

Karen Lusson
Citizens Utility Board
349 South Kensington Avenue
LaGrange, Illinois 60525

Allan Goldenberg
David Heaton
Assistant State's Attorneys
Public Utilities Division
69 West Washington, Ste. 700
Chicago, Illinois   60602

Phillip Casey
Hearing Examiner
Illinois Commerce Commission
160 N. LaSalle, Ste. C-800
Chicago, Illinois 60601

Matthew L. Harvey
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Ste. C-800
Chicago, Illinois 60601-3104

Cheryl L. Hamill
AT&T Communications
222 W. Adams St., Ste. 1500
Chicago, IL 60606

Clyde Kurlander
Attorney for NEXTLINK
Three First National Plaza
Suite 2315
Chicago, IL 60602

Eve Moran
Hearing Examiner
Illinois Commerce Commission
160 North LaSalle St., Ste. C-800
Chicago, IL 60601

Darrell S. Townsley
MCI Telecommunications Corp.
205 N. Michigan Avenue, St. 3700
Chicago, IL 60601

Calvin Manshio
Manshio & Wallace
4753 N. Broadway Ave., Suite 732
Chicago, IL   60640

John E. Rooney
Sonnenschein, Nath & Rosenthal
8000 Sears Tower, Suite 7800
233 South Wacker Drive
Chicago, IL 60604

Peter Nyce, Jr.
Department of the Army
901 N. Stuart Street
Arlington, VA 22203

Henry Kelly
Joseph E. Donovan
O'Keefe Ashenden Lyons & Ward
30 North LaSalle, Suite 4100
Chicago, IL 60602

Michael Ward
Michael Ward, P.C.
1608 Barkley Blvd.
Buffalo Grove, IL 60089

Susan Satter
Assistant Attorney General
100 W. Randolph Street, 11th Floor
Chicago, IL 60601

Owen E. MacBride
Terri Brieske
Schiff Hardin & Waite
233 South Wacker Drive
6600 Sears Tower
Chicago, IL 60606

Dennis Muncy
Joseph Murphy
Matt Deering
Meyer, Capel, Hirschfeld, Muncy, Jahn & Aldeen P.C.
306 West Church Street
Champaign, IL 61826-6750